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Energy Deals 2019

Merger and acquisition activity in Turkey's energy market

February 2020

Contents

Methodology and terminology

Energy Deals 2019 includes analyses of cross-border and domestic deal activity in the oil, gas and electricity markets in Turkey. The analyses are based on publicly available information and encompass announced deals as of 31 December 2019, including those pending financial and legal closure. Deal values are the consideration value announced or reported while the figures relate to actual stake purchases and are not multiplied to 100%. This document is also available at www.pwc.com.tr/energy-deals

Welcome

to the 12th edition of the Energy Deals, our annual analysis of mergers and acquisitions in the Turkish energy market

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We had not welcomed 2019 with high expectations about the deal environment in the Turkish energy market. And we were proven right. The dismal performance in total deal figures in 2018 even worsened in 2019 and reached a further lowest mark since we started to release this report in 2008.

In 2019, 22 energy deals could only generate an estimated and disclosed total value of US$ 600 million, marking 61% decrease from US$ 1.52 billion in 2018. For the first time since 2008, no privatisation took place in any segment of the Turkish energy market. In other words, all the deals happened between the private players in 2019.

We continue to explain this further weakening in the deal activity for the last two years with the unfavourable currency movements and diminishing availability of project finance in Turkey, which put a significant pressure on the market dynamics and the companies' balance sheets.

Turkish companies have borrowed around US$ 70 billion of foreign currency loans since 2003 to finance investments in power generation and distribution. However, due to the slowing growth in power demand, problems in power and gas market liberalisation, and the depreciation in the Turkish Lira, some utilities have become unable to generate enough cash to repay their foreign-currency loans. Thus, the market is closely watching the potential resolution measures which already includes loan restructurings as well as portfolio optimisations.

Total estimated value generated in the utility deals fell by 25% from US$ 800 million in 2018 to US$ 600 million in 2019. The worsening trading conditions for the gas-fired power plants and the narrowing window for coal-fired power plant financing made the renewable energy assets better acquisition targets. And, we believe that the approaching end of the feed-in-tariff mechanism (YEKDEM) in its current form contributed to this attraction. As a result, all of the 21 utility deals except two concerned renewable energy assets.

Except a few years with big tickets, oil and gas front has usually hosted less deals than the utilities. But 2019 proved an extreme in that only one small deal took place with an undisclosed value.

Looking ahead... At the end of the years with weak deal performances, we used to close our reports with remarks that investor community wants to see more to be done especially on the regulation and liberalisation fronts to get these deal figures back to their heyday. In 2020, this remark will be even more heavily tested with expected solution to bad loans, clarification for post-YEKDEM period, the outcomes of the announced IPOs, a more market-based approach to right the wrongs in regulation and maybe even some improvements in the difficult life of the fuel market players.

Deal totals: The lowest performance ever...

The dramatic downturn in the energy deals in 2018 became a free fall in 2019 and marked the lowest figures since we started to release this report in 2008.

22 energy deals could only generate an estimated total value of US$ 600 million, marking 61% decrease from US$ 1.52 billion in 2018.

This resulted in 59% of wipe out in average deal value to US$ 27 million per deal in 2019 compared to US$ 66 million in 2018.

21 deals were disclosed in the utilities segment in 2019 with an estimated total value of US$ 600 million. Similar to the previous years, the majority of the utility deals were in power generation, all in renewables. Limited diversification came with one deal in gas distribution and one in power trading.

For the first time since 2008, no privatisation took place in any segment of the Turkish energy market. In other words, all the deals happened between the private players in 2019.

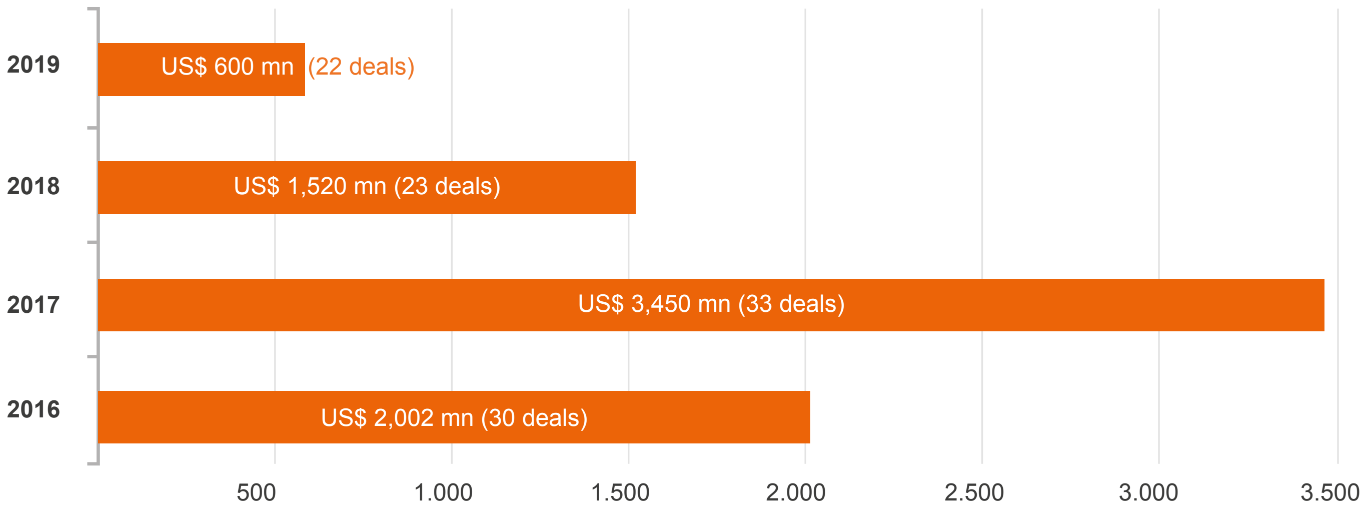
The total estimated total value of US$ 600 million corresponds to the value out of the utility deals, as the value of the single deal in the oil and gas segment cannot be estimated due to the lack of disclosure and benchmark in nature.

The dramatic downturn in the energy deals in 2018 became a free fall in 2019 and marked the lowest figures ever

Figure 1: Total Energy Deals in 2018 and 2019

	2018			2019			YoY change	
	Number	Value (US$ mn)	Average Value	Number	Value (US$ mn)	Average Value	% number	% value
Utilities	18	800	44	21	600	29	17%	-25%
Oil and gas	5	720	144	1	n.d.	n.d.	-80%	-
Total	**23**	**1.520**	**66**	**22**	**600**	**27**	**-4%**	**-61%**

Figure 2: Total deals between 2016 and 2019 by value (US$ million) and number of deals



With the lack of action on the privatisation front, all the energy deals were by the private players for the first time

The expected completion of the pending privatisations of the two thermal and twelve hydro power plants did not take place and all the energy deals were realised by private players in 2019.

The share of foreign investors overtook that of locals in 2019 with a clear score of 57% to 43%

With 57% - 43%, the total estimated value of the deals involving a foreign investor, either with single nationality or as a multinational entity, exceeded that of deals with Turkish buyers. This is a significant change since 2018, when almost entire deal value was created by the local buyers.

57%
foreign investors

versus

43%
local investors

Utilities: It is their story…

Unfavourable exchange rate movements and high borrowing costs continued to put a significant pressure on the market dynamics and the balance sheets of the Turkish energy companies.

Although the number of utility deals rose from 18 in 2018 to 21 in 2019, total deal value fell by 25% from US$ 800 million to US$ 600 million.

In 2019, the deepening loan repayment crisis between the Turkish banks and the power generation companies has become a case study item underlying the inevitable repercussions related to investments in developing countries with uneven progress in the liberalisation of gas and power markets, high currency and inflation risks and over-optimistic forecasts during investment planning.

Turkish companies have borrowed around US$ 70 billion of foreign currency loans since 2003 to finance investments in power generation and distribution. The project finance arrangements made with the Turkish banks in the meantime kept relying on the assumptions of high power demand growth, progress in gas market liberalisation to provide a reliable pricing and supply environment to power producers, and a strong Turkish Lira.

However, the power demand has not developed at the desired pace… And, the depreciation in the Turkish Lira reached around 70% over the last decade. As a result, some utilities are not earning enough to repay foreign-currency loans, posing a risk to banks.

According to state-owned Anadolu Agency, only US$ 23 billion of the US$ 70 billion of foreign currency loans mentioned above is repaid. US$ 40 billion of the remaining amount is owed by the power generators and US$ 7 billion by the privatised power distribution companies.US$ 12.8 billion of these loans carry high risk of default, with the following breakdown: US$ 5 billion by 7 thermal power plants using local coal, US$ 3.2 billion by 5 hydropower plants, US$ 2.7 billion by 8 gas-fired power plants and US$ 1.9 billion by 2 power distribution companies.

Since 2018, there has been some joint efforts by the Turkish banks and the Government to develop a resolution mechanism. The priority is to keep these plants operating and restructuring their debts. And, for the failed attempts, forming an Energy Venture Capital Fund by the creditor Turkish banks and transferring the indebted companies to this fund is discussed.

While the sector is still waiting for a concrete step in this plan, a recent development raised a question mark about it. In September 2019, Banking Regulation and Supervision Agency (BDDK) of Turkey asked the banks to write off loans amounting to US$ 2.5 billion (inc. interest) for three gas-fired power plants. As a result, the market remains vigilant about the next steps.

Against this background, the deal environment became even more quiet in 2019, with 19 deals in power generation, one deal in gas distribution and one in power trade. And, not surprisingly, all the deals in the generation segment concerned renewable energy assets, reflecting the considerations regarding the approaching end of the Renewable Energy Support Scheme (YEKDEM). As of 2021, the renewable energy investors will be no longer apply for the 10-year price guarantee under the current terms at the end of 2020, and uncertainties about what will happen after the termination of the scheme still continue. We think that this situation made some of renewable energy assets on our deals list with still three to six years to the end of their price guarantee period attractive to the investors.

Now, a closer look on the major deals…

One of the largest deal of 2019, a replacement of a foreign investor by another one, was the acquisition of EWE Turkey Holding by SOCAR Turkey Enerji. The deal includes 80% shares in two gas distribution companies, namely Bursagaz and Kayserigaz, and 100% shares in the trading and sales company EWE Enerji, the energy service company Enervis and the telecommunications company Millenicom. This acquisition is considered an important step in SOCAR's efforts to build a vertically integrated structure in the Turkish energy market. With this deal, the company is now present in gas distribution to more than 1.5 million customers in two large Turkish cities, in addition to its operations in refining, petrochemicals, gas pipelines / storage / transportation, and power generation.

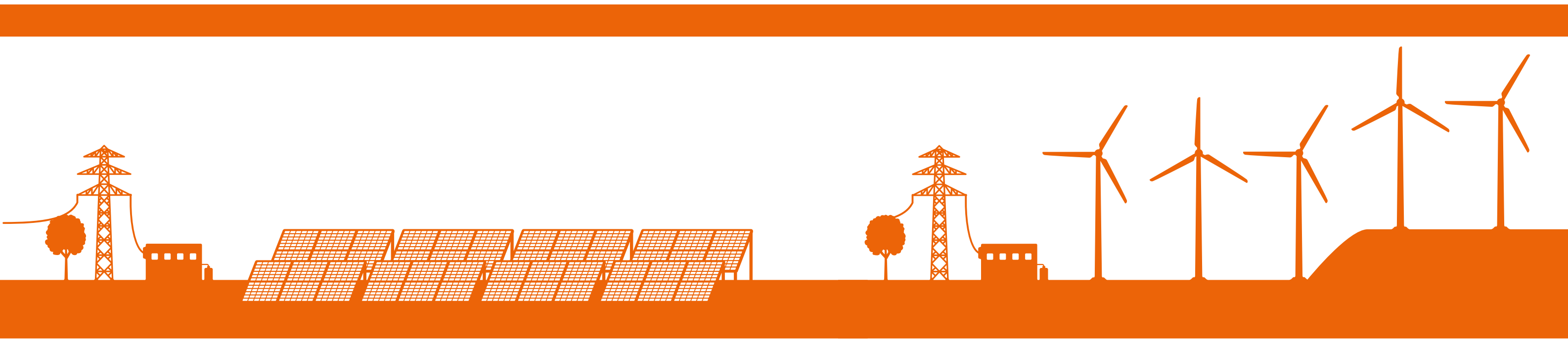
The largest deal in power generation was EBRD's US$ 100 million investment in a stake of Ictas Surdurulebilir Enerji Yatirimlari, the renewable arm of Turkey's IC Energy Holding. The company owns a portfolio of ten hydropower plants with a total capacity of 400MW. With EBRD funds, it plans to invest in wind farms and solar projects with a combined capacity of up to 250MW. The EBRD investment will also partly finance the company's winning bid in the recent privatisation of 126MW Kadincik hydropower plant in the south of Turkey. EBRD has been an important supporter of renewable energy investments in Turkey with similar investments and project finance facilities. The Bank has financed – directly and via loans to Turkish partner banks – 3GW of installed renewable capacity in wind, solar and geothermal projects so far.

Next come two interrelated deals among partners. In the first one, Polat Enerji bought 50% shares from its partner Demirer Enerji in Doruk Elektrik owning 36MW Seyitali WPP (operating) and Poyraz Enerji owning 67MW Poyraz WPP (operating) and has become the sole owner of the two companies. And in the other deal, Demirer Enerji, Zeki Aybar Eriş, Demirer Family bought 50% shares from Polat Enerji in Dogal Elektrik, owning 57MW Sayalar WPP, 44MW Samurlu WPP, 35MW Kozbeyli and 15MW Burgaz WPP (all operating), and have become the sole owners of the company.

The next two deals were by the same buyer, a consortium by Kangal Elektrik, a local renewable energy company and Is Portfoy, the asset management subsidiary of Is Bank, the largest private bank in Turkey. Together, they acquired the Akış Enerji A.Ş holding a 104MW WPP license from Bereket Enerji and Besiktepe Elektrik owning the 44MW Kiyikoy WPP (operating).

A deal that failed to see the checkered flag in 2018 was completed in 2019 with a different buyer involving a foreign partner. STFA and UK-owned RES Anatolia sold 120MW Evrencik WPP (license) to the consortium of two textile companies and three local individual investors: Aunde Teknik of Germany, COYS Tekstil of Turkey, İrfan ACAR, Yılmaz ACAR and Gülseren ACAR.

In two deals featuring a foreign player's exit, Hanwha Q Cells of South Korea pulled out of a partnership in solar energy with Turkey's Kalyon Group and then completed its exit from the Turkish market by selling its solar power projects again to a consortium of Guclu Tekstil, a Turkish textile company, and local private investors.



The consortium of Kalyon Enerji and Hanwha Q Cells won 1GW Konya Solar PV tender in 2017 offering to sell the generated electricity at a feed-in tariff of $0.0699 per kWh for 15 years, free of currency risk. In return, 60% of the first 500MW is required to be built with locally made components. To that end, the consortium announced a new manufacturing plant in 2017. However, in 2019 Hanwha decided to leave the project. To build the required factory, Kalyon has signed a co-operation agreement with CETC Solar Energy Holdings Co Ltd, a subsidiary of the Chinese state-owned military surveillance contractor China Electronics Technology Group Corporation. To facilitate the investment, the Turkish government announced it would contribute a “super incentive” of TL 1.99 billion (US$ 333 million). And, the factory will be exempted from customs tax and VAT as well as other fiscal and employee incentives including health insurance premiums and support for qualified personnel.

Akfen Renewables continued its growth in 2019 as well by acquiring 23MW Demirciler WPP and 57MW Saritepe WPP (both operating) from Zorlu WPP company. With EBRD and IFC in its shareholding structure, Akfen increased its renewable PP portfolio to 712MW towards its investment target of 1,000MW.

Albeit not within the ‘deal’ definition in this report, IPOs are worth mentioning as they constitute a reliable test of investor appetite for the Turkish energy market.

Naturel Enerji, a pure play solar power generation company sold 36.36% of its shares at Borsa Istanbul in 2019, to become the first listed company in this segment in Turkey. The company’s 22MW of PV capacity enjoys the 10-year guarantee by feed-in tariff mechanism.

Figure 3: Utility Deals in 2019

Date Announced	Target	Stakes in %	Acquirer	Acquirer Nationality	Deal Value (US$ mn)
16-Jan-19	Ucgen Seferihisar Ruzgar Enerjisi	100%	Ustyapi Insaat Ve Madencilik	Turkey	n.d.
30-Jan-19	EWE Turkey	100%	Socar Turkey Enerji	Azerbaijan	n.d.
13-Feb-19	Hanwha Kalyon Gunes Enerjisi	50%	Kalyon Enerji Yatirimlari	Turkey	n.d.
8-Mar-19	Egin Enerji Uretim	9%	MMC Sanayi Ve Ticari Yatirimlar	Turkey	0,4
1-Apr-19	Bestepeler Enerji Uretim	n.d.	Pan-African Soleil Holdings	Singapore	n.d.
10-Apr-19	Evrencik Ruzgar Enerjisinden Elektrik Uretim	100%	Acarlar Dis Tic. & Aunde Teknik & Coy Tekstil	Turkey	n.d.
11-Apr-19	Bozat Elektrik Uretim	100%	Ulusoy Elektrik Enerji Yatirimlari	Turkey	4
8-May-19	IC Ictas Surdurulebilir Enerji	n.d.	EBRD	Multinational	100
14-May-19	Gonen Yenilenebilir Enerji	70%	Toros Tarim	Turkey	5
21-May-19	Cumra Gunes Enerjisi	100%	KHM Enerji	Turkey	6
29-May-19	Akis Enerji Yatirim Uretim	n.d.	Kangal Elektrik & Is Portfoy	Turkey	n.d.
30-May-19	Ares Elektrik	100%	Fina Enerji, Canres Elektrik	Turkey	n.d.
17-Jul-19	Steag Enerji	50%	Oyak Enerji	Turkey	n.d.
6-Aug-19	Hacim Enerji	100%	Eksim Holding (Iklim Elektrik)	Turkey	n.d.
19-Aug-19	Karhes Elektrik Uretim	24%	Bereket Enerji	Turkey	7
2-Sep-19	SPP companies of Hanwha	100%	Guclu Dokuma Tekstil and Private Investors	Turkey	n.d.
26-Nov-19	Doruk & Poyraz Enerji Elektrik Uretim	50%	Polat Enerji	Turkey	n.d.
26-Nov-19	Dogal Enerji Elektrik Uretim	50%	Demirer Enerji & Zeki Aybar Eris & Demirer Family	Turkey	n.d.
3-Dec-19	Besiktepe Enerji Uretim	100%	Kangal Elektrik & Is Portfoy	Turkey	n.d.
24-Dec-19	Zorlu Ruzgar Enerjisi (Sarıtepe and Demirciler WPP)	100%	Akfen Yenilenebilir Enerji	Turkey	n.d.
31-Dec-19	20 SPP of Girisim Elektrik	100%	Naturel Yenilenebilir Enerji	Turkey	n.d.
Total				≡	**600***

n.d.: not disclosed

*: Includes estimated deal value for undisclosed deals

Oil and gas: It was all very quiet…

After the vibrancy of 2018, 2019 was an extremely quiet year in the Turkish oil and gas deals environment.

One single deal took place, in which the consortium of THY, Total Oil and Zirve Holding acquired share in IGA Havalimanı Akaryakıt Hizmetleri, a service company providing fuel supply and related services at the Istanbul Airport.

Against this quiet background in 2019, 2020 started with the sale of Total Turkiye and M Oil by Demiroren to OYAK Pension Fund for US$ 360 million and US$ 90 million respectively. This has been the first disclosed large deal in the fuel retail market since the sale of Petrol Ofisi in 2017. Behind this stagnation in the deal space are counterproductive regulation of the fuel retail prices and the share of the gas stations in the total margin making hard to cover the operational expenses.

The IPO intention disclosed by Global Investment Holding to list their non-pipe natural gas and CNG subsidiary Naturelgaz to Borsa Istanbul is expected to materialise in 2020.

Looking ahead

The significant move by the Turkish Government on the very first day of 2020 to suspend the operations in five large coal-fired power plants due the lack of compliance with the investment requirements to reduce the emissions of hazardous gases and particles despite all the deadline extensions signalled an important message: the regulations are now better enforced for the public good.

Although this is a step in the right direction, more needs to be done to take the Turkish energy market back to its days of stellar performance. The growing debt burden has spillover costs on the entire economy. A solution to it by increasing the pressure on the banks will eventually hit the public by offsetting the benefits of better regulations.

The deal environment in 2019 showed that even in such hard conditions, renewable energy assets continue to attract investment. Thus, the lowest hanging fruit to maintain this interest and to unlock even more foreign capital is the immediate clarification for what is ahead in the feed-in-tariff mechanism once the current system ends by 2021.

This is not a concern only for the existing and potential investors, but also for some multinational financial institutions. For instance, EBRD is known to have already contributed its ideas to the Turkish Government about the new system. A new regulation issued in 2019 has already started to pave way for more investment in unlicensed solar PVs by increasing the limit from 1MW to 5MW and enabling the sale of excess output after own use to the power retail companies in their region. According to the feedbacks we receive from the market players, the complications about the clearing system with the power retail companies are yet to be ironed out. With the immediate resolution of these issues, we believe that sizeable portfolios to be put together with these small power generation units would have a good chance to find investors, and also end in more investment into equipment manufacturing in Turkey.

In fact, according to the EMRA, 2020 will be the year of solar power, as the regulator is already working on a new 'hybrid power plants regulation' which will enable the installation of solar PVs within all types of power plants and permit the sale of the output in addition to that from the main source. This is expected to attract interest from the hydropower plant operators in particular, who need a solution to mitigate the impact of evaporation on their output.

Concerning solar power, the YEKA tenders are worth mentioning as well, although they are not directly generating 'deals' within the definition of it in this report. Following the large scale tenders in the last couple of years, next will be the small scale packages of 10-50MW. Following a recent statement by the Ministry of Energy, the tenders will be held in April or May 2020 in almost 40 provinces across the country, as the total capacity covered by the applications is expected to come in at between 4,000 and 5,000MW. We understand the motivation behind this shift is to provide an easier financing environment than in the large scale projects, which may later end in a boost in the deal environment as well.

The fate of the gas-fired power plants is anybody's guess. Their share at 37% in the total generation in 2017 dwindled fast to 18% in 2019 due to elimination of the least efficient ones from the system, in addition to the rise in the share of the renewables. Some generators like Zorlu and Aksa are known already dismantling their inefficient turbines and selling them abroad. This trend, coupled with the fact that the US$ 2.7 billion loan to 8 gas-fired power plants being within the bad loan pool in urgent need of restructuring, is in a way explaining the inadequacy of the capacity mechanism to keep them afloat. Under this climate, we assume that the privatisation of the 1,432MW Bursa and 180MW Aliaga CCGTs is no longer even discussed.

Talking about the privatisations, the twelve hydropower assets put on the privatisation list in 2017 are still waiting to be tendered: Akkopru HPP (115MW), Camlica 1 HPP (84MW), Kesikkopru HPP (76MW), Demirkopru HPP (69MW), Seyhan-1 HPP (60MW), Topcam HPP (60MW), Derbent HPP (56MW), Camligoze HPP (32MW), Kepez HPP (26MW), Seyhan-2 HPP (8MW), Yuregir HPP (6MW) and Kepez 2 HPP (6MW). The lack of official update about their status is signalling that no action would take place in 2020 either.

Going down the utilities value chain… The power retail and distribution companies are likely to continue their internal restructuring to increase the resilience of their balance sheets and to generate solutions.

On the gas distribution front, despite the completion of the municipal elections, no clear guidance is available about the future of IGDAS. But we would still expect similar deals to EWE-SOCAR mentioned in this report to take place in 2020 as well.

Making predictions about the oil and gas deals is still very difficult as the nature of the deals continues to be quite sporadic and not necessarily a direct reaction to the market developments. For instance, over the last couple of years, we have been hopeful that the regulation giving EMRA more grip on the enforcement of the national stock requirement regulation with instant online access to the storage facilities would result in some deals by the players with inadequate storage capacity. But this did not stimulate any transaction so far.

A long forgotten event in the Turkish energy market, IPOs are expected to be back to stage in 2020, according to recent disclosures.

Global Investment Holding disclosed their plans to list their natural gas subsidiary Naturelgaz to Borsa Istanbul. According to the company sources, the company has around 20% share in Turkey's non-piped natural gas transport sector, as well as a 75 % share in the compressed natural gas (CNG) market. It is also Europe's largest CNG supplier and distributor in terms of mother station infrastructure and bulk sales volume.

Another IPO announcement has been recently made by Izdemir Elektrik Uretim, a power generator company with a 350MW imported coal PP, owned by Izmir Iron and Steel Co. The growing reaction to coal PPs on among the global investors and the less favourable status of the plants using imported coal in Turkey will inevitably weigh on the outcome.

At the end of 2018, we had said 'unfortunately, we do not have much input to stay optimistic about 2019.' And we were proven right. Now, a month into 2020, all the issues discussed in this report carry the red alarm of their own and we genuinely hope that the right steps will be taken by the energy administration to help this market full of potentials to receive the deserved interest.

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