Despite the situation caused by COVID-19, the opportunities offered by the domestic renewable energy market keep attracting large private equity, pension and global infrastructure funds, which concentrate their investment activity and people in Spain as never before. Additionally, they are doing so by investing not only in projects with regulated remuneration, but also in "merchant" projects where a number of Spanish banks have started to act as arrangers on the financing of greenfield projects. All of this is happening in a market in full swing this year and where private equity has enhanced the rotation of its portfolios and renewable platforms.

"LEADING GLOBAL FUNDS CONTINUE TO LAND IN MERCHANT PROJECTS IN SPAIN DESPITE COVID-19"

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WATSON FARLEY & WILLIAMS

The renewables transaction market has experienced a moment of real effervescence in Spain, why?

Since the end of 2017, Watson Farley & Williams has been anticipating growth in renewable energy M&A and these forecasts have come true. This is due to several factors. Firstly, because of the greater variety of assets the sector is offering which are attracting international investors with different risk profiles. For example, funds such as Helios, Copenhagen Infrastructure Partners (CIP), Noy, Macquarie, Ontario Pension Trust, Green Investment Group (GIG), Northleaf or Brookfield are breaking into this market, attracted by a much wider range of investment opportunities, not only in terms of quantity, but also because of their varied risk profile. We no longer see only private equity funds, but also infrastructure and pension funds that seek returns that are not necessarily as high, but more stable and secure, and that can coexist with the more opportunistic or less risk-averse funds that arrived in Spain after the recent regulatory changes. It is a development that we anticipated and that has happened.

We have seen large operations, highly relevant in terms of size. Did the market expect these large megadeals?

Yes, this was clear to us. Market consolidation has brought together brownfield assets in a process of building up, and these portfolios have also been joined by greenfield projects. We are already seeing mixed portfolios. Cerberus was the first to initiate a build-up strategy with us, buying a portfolio and a platform like Renovalia and then adding numerous assets to create a larger portfolio that it successfully sold. We have moved from a market where investors were mainly buying individual assets to the acquisition of large portfolios and even acquisitions of platforms and companies with a more industrial profile in the sector. And the third derivative is energy companies with several hundred employees - some of them barely six months old - which, while they were being created, were also being bought. That's why the evolution has been so exciting. At the same time as the product is being created, it is also being bought.

In this market context, what kind of investors can we find?

It is certain that, in this context, we find increasingly sophisticated investors with a deeper knowledge of the sector. The management of brownfield operational assets is relatively simple, with operation and maintenance contracts and asset management not looking to minimize the analysis of regulated profitability, financing management, etc. However, regarding greenfield assets, investors are entering for the full life of a project, assuming construction and even development risk. We used to see mainly utilities and construction companies in such circumstances, but this has changed recently. The funds that are now taking such risks have very diverse profiles. Moreover, in development and construction there is a certain economy of scale which enables funds to leverage their previous experience and expertise to reduce time and costs going forward. In terms of assets' risk profile, we have seen an evolution from regulated remuneration to auction projects with a cap and a floor to, more recently, merchant projects with (or even without) power purchase agreements (PPAs) with investors assuming pure merchant risk in an expanding market to manage this risk (from short-term PPAs to pure energy management). All of this requires much more sophisticated management, but also allows one to extract the maximum return.

Will this trend continue after COVID-19?

During the first days or weeks of COVID-19 in Spain, we experienced uncertainty regarding how the market might react. Energy price predictions and expert curves have shown lower values for the next few years, which made buyers think about not only the price ranges they could offer, but also the type of asset they wanted to buy (regulated remuneration, merchant, etc). In the same vein, sellers had to perform a self-analysis of the potential pre-adjustment of their assets. These moments have been a challenge to the sector. However this didn't translate into a decrease in the number of transactions. It is true that some investors do not feel as comfortable in this environment, but players who have their own vision of demand and prices in the medium term, maintain their interest in the sector and know how to value the virtues of energy assets. The challenge is now to find the sweet spot where sellers and buyers align their legitimate expectations on price adjustment.

In this context, what is the advisor's role?

The advisor's role makes more sense than ever now, given the need to evaluate risks and timing more efficiently. Timing is fundamental for a deal to be successful. Being a regulated sector, energy requires a great deal of specialisation and knowledge. An advisor must be able to identify risks very well and calibrate those that would have a real impact, as well as quantify them in the transaction and recognise those that can be a deal-breaker. The most effective buyers know how to manage and value risks and contingencies better. Here is when the advisors play their key role, avoiding ringing alarms where there is no real risk and quickly identifying those that are genuine. Some operations have been aborted or delayed for months because of this. There are few insurmountable risks, but all contingencies have a price. In the greenfield world, moreover, many of the risks translate into longer development time. And time, of course, is money. A greenfield project with certain development risks - not only regulatory, but also land insurance, environmental, archaeological, etc. - can extend a project from 12 months to 24-48. If we talk about a three or four year-delay, the product has already changed, with a new price and not only because of the obvious delay in receiving income, but also because of the expectation of different energy prices, etc. Time, therefore is of the essence. In a post-COVID-19 context, where uncertainties are greater, a truly expert advisor with a broad and deep vision of the assets and the sector in the medium and long term, is essential to provide certainty to buyers, find angles of value in projects and ultimately put a price on transactions.

WFW Madrid partners (pictured).

You have once again advised Cerberus on the sale of its portfolio to F2i. Will we continue to see more changing of ownership of large platforms of this type?

Yes, because of private equity cycles and the great value creation work in the sector that funds have carried out in build-up processes, especially in the consolidation of the photovoltaic and wind sectors. For example, Danish and other Nordic funds are investing heavily in wind energy because many of them are historic, specialised investors in both onshore and offshore projects. Their entry in Spain has obviously been through onshore technology, as we are seeing with CIP's acquisition of large wind portfolios from Forestalia. First-rate international investors, large infrastructure funds and global pension funds have made a strong commitment to Spain because they perceive it as a safe market. This has not changed because of COVID-19. These funds are looking to invest in "merchant" projects, without regulated remuneration. They want to concentrate their efforts in Spain because they have a lot of liquidity and because the national market offers a very attractive risk/returns.

How are these new greenfield projects going to sell energy without tariffs?

By various means. On the one hand, they will sell it through PPA contracts. This is one of the big challenges - signing long-term PPA contracts with solvent counterparts with significant balance sheets. But, beyond disposals of large volumes of MW in PPAs, in Spain as well as elsewhere in Europe there is a mid-market where the great challenge is to manage all the merchant projects that require certainty in the sale of their output (often so as to have access to bank financing) but do not have access to the market for large PPAs. It is therefore likely and desirable that, progressively, a midcap PPA market will be created with aggregation of off-takers or any other formula that allows "mutualizing" off-taker risk and making projects bankable. We are working on some very interesting projects in this regard. On the other hand, there are, as we said before, those investors who feel comfortable only managing energy sales.

National banks. Are they still not in the merchant world?

There are two or three national financial entities assuming the role of arrangers, i.e. structuring merchant project finance without PPAs. And these entities, in collaboration with national and international banks, have already entered the market which has room to grow and develop. When it comes to risking capital, one needs to highlight the key role private capital is playing in financing development and construction. On the other hand, along with traditional bank debt, there are also the bondholders, entering the market, especially for brownfield projects involving photovoltaic technology and refinancing. We have advised on several bond issues already subject to Spanish law.

Why has the Spanish office of Watson Farley & Williams been key in the development of the European business?

For a firm like ours, who are energy experts at a global level, it is easier to advise on highly sophisticated and complex cross-border transactions, because all our offices have the same level of expertise. We possess not only legal and regulatory knowhow, but also a deep knowledge of the sector itself. This is what makes a difference. In addition, Spain has been a pioneer in renewables and continues to be so in the merchant world. In our Madrid office we have been very active creating markets and attracting new players to the sector and they are all still with us. We set up in 2009, a difficult time, and managed to be the gateway for many large funds worldwide and have grown alongside them, reaching a 70-people staff in Madrid.