BRIDGE TO INDIA

November 13, 2017

India RE Weekly

Renewable M&A still stuck in second gear

M&A activity in the Indian renewable sector has been building up for some time. Last month, Equis announced the sale of its 4.7 GW Asia pacific renewable IPP business to a consortium comprising Global Infrastructure Partners (GIP), China Investment Corporation and Public Sector Pension Investment Board of Canada. The Equis portfolio comprises over 600 MW of renewable assets in India including 414 MW of operational wind and 130 MW of operational solar assets. Meanwhile, First Solar sold its entire 190 MW of operational solar portfolio to IDFC Alternatives, an India based infrastructure PE fund in July 2017.

- Sector M&A is highly desirable as it allows for optimal allocation of risk capital and consolidation in a highly commoditized sector;
- Valuation mismatch has been preventing many deal closures but buyers have the upper hand;
- Sellers need to be realistic as the longer they wait, the higher the risk of deals turning sour because of due diligence problems;

There are many positives from the M&A activity. First, the strong profile of buyers comprising sovereign wealth funds, pension funds and infrastructure PE funds brings more patient capital and is a sign of confidence in the Indian RE business. Second, the sellers free up their capital for potential use in development of further assets.

The big puzzle is that there are not more such M&A announcements. The RE business structurally lends itself to consolidation as it has almost no entry barriers and is highly commoditized. Scale brings important benefits in fund raising and portfolio management. With project development activity slowing down and the auctions becoming extremely competitive, it is natural for small to mid-sized developers to look to exit the business or simply churn their portfolio. Some of the rumoured sellers include Ostro Energy (portfolio of over 1,000 MW including under construction assets), Essel Infra (710 MW), Orange Power (600 MW), Shapoorji Pallonji (454 MW), SkyPower (350 MW), Fortum (185 MW) and FRV (100 MW). The buyers, on the other hand, are developers or investors that have raised substantial funds and are keen to deploy those to build up scale. Potential buyers include Greenko, ReNew, Hero Future, Sembcorp, Hinduja and Macquarie, amongst others.

Slow progress in deal closures can be explained by two main hurdles. First, there is still a wide valuation gap between buyers and sellers. Second, due diligence on RE assets can often throw nasty surprises. Payment delays, grid curtailment, land acquisition and poor construction quality issues can scare away buyers. Valuation mismatch is the easier of the two hurdles. Buyers are holding out for leveraged equity returns of 14-15% and we believe that sellers have no choice but to give way for more deals. If they wait for too long, they run the risk of more due diligence issues arising over time and buyers turning away. Moreover, there is a view that debt financing cost, which has been coming down for last three years, may have bottomed out. In other words, if you are an interested seller, better move fast now.