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Energy Deals
Mergers and acquisitions activity within the Turkish energy market

2010 Annual Review

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Contents

Methodology and terminology

Energy Deals 2010 includes the analysis of cross-border and domestic deal activity in oil, gas and electricity markets in Turkey. The analysis is based on publicly available information and encompasses announced deals as of 31 December 2010, including those pending financial and legal closure. Deal values are the consideration value announced or reported and figures relate to actual stake purchase and are not multiplied to 100%. All presented totals of deals are inclusive of estimates for deals with no reported value. This document is also available at *www.pwc.com/tr/energy*.

Welcome
to the new format of our annual review of the deals environment in the Turkish energy sector

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"We hope to see the ongoing regulatory challenges and financial problems ironed out and translated into record-breaking deal values in 2010."

These were the closing comments of our Energy Deals 2009 report. Our expectations were met, in that the deal environment was distinctly busy for the second half of 2010, mainly on the back of the rush to wrap up the tenders for the long-awaited big tickets in the utilities sector. Total deal number hit 53, amounting to US$17.2bn, mainly comprising privatisations concluded in the electricity distribution and retail segments. This made a pleasant contrast to the entirety of 2009, when the transaction machine halted for the evident reasons. Not only that, it was also a better year than 2008, which we had termed at the time "a record year".

It seems things are getting back to normal. But it is definitely a *new normal*, simply because what the markets went through over the past two years has redefined the way deals are engineered. Although the financial markets have recovered, debt financing is still harder to secure than it was before the crisis, and investments require more equity.

On the other hand, regulatory certainty has strengthened its position among competitiveness criteria, and its absence is reflected in the lack of representation among international players and private equity investors, particularly in utility transactions within the Turkish deal arena.

Looking ahead, while it is hard to expect 2011 to be a carbon copy of 2010, the expected kick-off of the long-awaited privatisation of the state electricity generation assets and natural gas distribution company in Istanbul (İGDAŞ) will probably constitute the backbone of our next Energy Deals report. The legislative and structural push towards consolidation and vertical integration among the growing discussion on the margins in the petroleum market, on the other hand, is likely to awake the deal environment in this segment.

We hope you find this third issue of our Energy Deals series enlightening and that it assists you in understanding what drives the deals and how this is reflected in the evolution of the energy business in Turkey.

Report highlights

An almost unbreakable record year

Despite the effects of the global crisis, the Turkish deal market's post-crisis recovery in 2010 was so strong that it saw more than double the combined deal value of 2007, 2008 and 2009. US$17.2bn was generated from a total 53 deals. The average deal value hit US$325mn, more than tripled the 2009 average of US$87mn. In the same vein, the share of public deals by value improved to 86% in 2010. Utility transactions failed to attract foreign players, mainly due to the ongoing regulatory uncertainty in the Turkish market. By comparison, the oil and gas front attracted more international interest.

It was all about utility privatisations

Privatisation of power and gas distribution companies made the utilities sector the transaction hub of 2010, with 12 tenders out of 53 deals in total. Tenders for 11 power distribution companies and Başkentgaz raised US$13.5bn in total, 79% of the total deal value in 2010. Of this, US$6.7bn was from a single company, MMEKA, either by itself or via JVs. However, the latest decision by the Competition Authority blocking the way for the highest bidders for Boğaziçi, Gediz, Thrace and Dicle, moving to prevent potential dominance of the electricity distribution market will change this figure, unless potential legal action by the companies overturn this decision.

Private deals in the power generation segment were mostly for assets at the non-operational stage. In the total capacity of 2.7 GW that changed hands in 2010, the share of HPPs was c. 45% and the rest was made up of thermal PPs, with no share for other renewables, to some extent reflecting the fading excitement about them among the decision makers.

Just the beginning for oil and gas

Deals in the oil and gas arena tripled their share of total deal value to 10% in 2010. The OMV-Petrol Ofisi deal was particularly significant, as it represented a shift in market leadership from a local player to an international one.

The Competition Authority's decision to limit the duration of the usufructs and rental contracts between distributors and dealers to five years came to remodel market scenarios; minimising upfront payments and investments by distributors while reducing their margins. With the recent open call by the government to market players, asking them to align margins with the European average, the result is now much closer to consolidation necessary for survival in this segment.

Our predictions last year fared well, and we started to see transactions in the storage segment increase in number, mainly due to National Stock Requirements coupled with the scarcity in available land.

Welcome to the world of the new normal

The upswing in the Turkish energy market is confirmed within the *new normal:* steady growth in demand versus ongoing uncertainty, coupled with scarcer credit creation. Accordingly, the closing of the recent utility tenders must be closely tracked, and it would not be surprising to see this leading to new transactions as part of the search for required finance.

The calendar for the privatisation of the state electricity generation portfolios is to span 2011 and 2012. The İGDAŞ tender is another *mega deal* in the pipeline. Higher foreign interest is the market expectation, despite regulatory uncertainty.

We anticipate positive signals regarding WPP licensing to lead to a lively deal environment. Nonetheless, we do not expect that the ratification of the amendments to the Renewable Energy Law will boost investments and as such the deal activity in this area.

The recent shake up in contracting, and growing discussion about the above-EU average profitability margins will push further consolidation among fuel distributors, as well as vertical integration along the value chain.

It will be hard to match 2010. Nevertheless, on the back of the upcoming generation assets privatisations, it is still realistic to expect strong deal prospects in 2011.

US$17.2 billion

of energy deals in 2010; more than double of combined 2007, 2008 and 2009 value

Deal totals: an almost unbreakable record year

Despite being affected by the global crisis, the Turkish deal market's post-crisis recovery in 2010 was so strong that it saw more than double the combined deal value of 2007, 2008 and 2009.

In 2010, the Turkish energy market hosted a total of 53 publicly disclosed deals, versus 19 in 2009. The overall combined deal value hit US$17.2bn, with an average deal value of US$325mn, more than tripling the 2009 average of US$87mn.

Transactions in the utilities segment continued to make up the majority of activity, comprising 48 of 53 deals in total number and 90% of the total deal value. Compared to 2009, mostly as a result of full compliance with the privatisation calendar, the total number of utility deals and the average deal value both tripled in 2010; the total utility deal value grew tenfold.

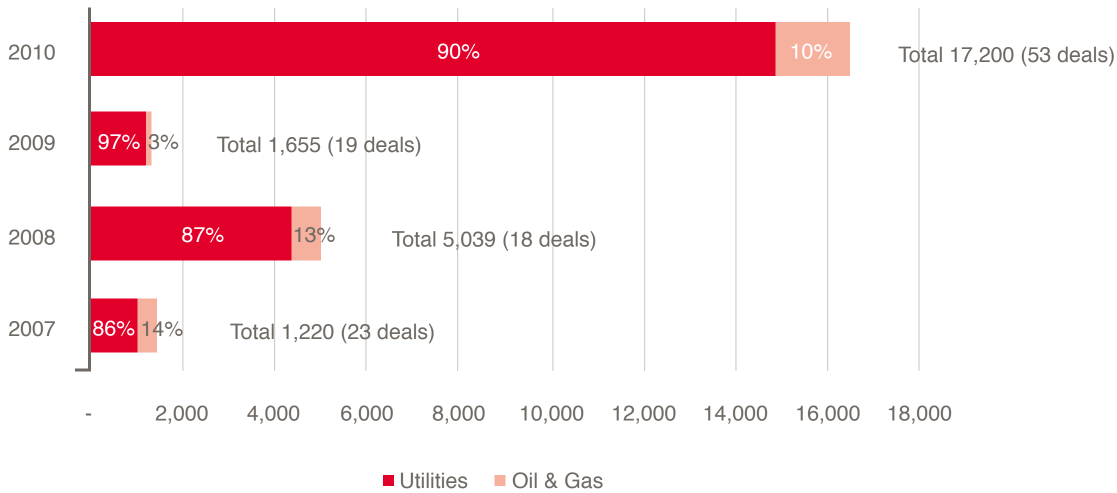
Activity in the Turkish oil and gas market also picked up, with the completion of a long-awaited transaction in the fuel retail market. Stricter regulatory enforcement in the storage segment, on the other hand, proved right our predictions in last year's report and ended in a majority stake acquisition. Together with other deals in the E&P and LPG markets, the total deal value in this market increased from only US$55mn in 2009 to US$1.7bn in 2010, with an average deal value of US$340mn – higher than that for utility deals.

The total deal value in 2010 rocketed to US$17.2bn, higher than ever, mainly thanks to a firm commitment to finalising utility tenders

Figure 1: Total Energy Deals in 2009 and 2010

	FY09			FY10			YoY change	
	Number	Value (US$mn)	Average Value	Number	Value (US$mn)	Average Value	% number	% value
Utilities	17	1,600	94	48	15,500	323	182%	869%
Oil and Gas	2	55	27	5	1,700	340	150%	3002%
Total	**19**	**1,655**	**87**	**53**	**17,200**	**325**	**179%**	**939%**

Figure 2: Total deals between 2007 and 2010 by value (US$mn) and number of deals



The rule did not change in the public-private deals split, thanks to the completion of 11 tenders for utilities. Despite making up just 21% of the total deal number, the share of public deals by value increased from 72% in the previous year to 82% in 2010.

82%
value generation for public deals
versus
18%
for private deals

88%
local involvement
versus
12%
foreign

An analysis of deal actors' origins displays a striking difference between the utilities and oil and gas markets. Despite the resilient demand prospect for power and gas, the transactions – and in particular the privatisation tenders – failed to attract foreign players, including private equity investors. This was mainly due to the ongoing regulatory uncertainty in the Turkish market. On the other hand, international names from Austria and the US found the oil and gas front more investment-worthy and were involved in three of the five deals. Ultimately foreign participation by number decreased from 25% in 2009 to 12% in 2010.

Utilities: transaction hub for 2010

Electricity distribution company deals rocketed to US$12.3bn

Privatisation of power and gas distribution companies, i.e., the transfer of operational rights for distribution and retail services until 2036, made the utilities sector the transaction hub of 2010. Of 20 power distribution regions that had been put on shelf back in 2004, 11 were tendered this year on the back of the dedication to comply with the already delayed schedule. These regions were Fırat, Vangölü, Çamlıbel, Uludağ, Trakya, Dicle, Toroslar, Akdeniz, Boğaziçi, Gediz and İstanbul Asian Side (AYEDAŞ) with an aggregate supply of 86.4 TWh to 18 million consumers in 2009. The bid for five of them, namely Toroslar, Akdeniz, Boğaziçi, Gediz and AYEDAŞ, exceeded the psychological bid threshold of US$1bn; the total raised by these 11 tenders for the power utilities reached US$12.3bn, 72% of the total deal value in 2010. And US$6.7bn, or 54%, of this figure was from a single company, MMEKA. However, the latest decision by the Competition Authority, blocking the way for the highest bidders for Boğaziçi, Gediz, Thrace and Dicle and moving to prevent potential dominance of the electricity distribution market will change this figure, unless potential legal action by the companies overturns this decision.

The current figures pushed the average bid value per MWh from US$101.4 in 2009 up to US$143 in 2010. This can be explained by the facts that the big tickets were kept to the end, that distribution and retail is the key to vertical integration down the value chain and, last but not least, this will not happen before 2036, excluding the small probability of the licences' changing hands in the meantime.

Deals remaining to be completed

Despite high expectations, 2010 was not the kick-off year for the privatisation of the state power generation portfolios, excluding the tender for the operational rights to a small hydropower portfolio totalling 162MW. The private deals in this segment were mostly for assets at the non-operational stage. Given the long licensing period and scarcity of opportunities for promising green-field start-ups, the interest in HPPs intensified, making up c. 45% of the total capacity of 2.7 GW. Subject to these transactions, the rest wholly comprised thermal PPs.

The absence of WPPs in this picture is hardly surprising, largely due to the licensing process, which has been delayed since 2007, and fading hopes regarding the upward amendment in the feed-in tariff levels for renewable power generation.

Figure 3: Utilities deals in 2010

Date Announced	Target	Stakes in %	Acquirer	Acquirer Nationality	Deal Value US$mn
8-Jan-10	BiS Enerji	50%	SGM Enerji	Turkey	250
19-Jan-10	Two local hydro projects	100%	EnerjiSA	Turkey	n.d.
18-Feb-10	Firat Elektrik	100%	Aksa Elektrik	Turkey	230
18-Feb-10	Vangolu Elektrik	100%	Aksa Elektrik	Turkey	100
18-Feb-10	Camlibel Elektrik	100%	Kolin Insaat	Turkey	259
18-Feb-10	Uludag Elektrik	100%	Limak Insaat	Turkey	940
11-Mar-10	Ickale Enerji	100%	Akenerji	Turkey	n.d.
24-Mar-10	Six local hydro projects	75%	Reservoir Capital	Canada	23
30-Apr-10	Five local hydro projects	100%	Energo-Pro	Czech Republic	404
10-May-10	Energaz	47%	STFA	Turkey	n.d.
3-Jun-10	EUAS power plants (18 groups)	100%	Various companies	Turkey	440
3-Jun-10	Anel Enerji	5%	Ralos New Energies	Germany	11
17-Jun-10	Idil Iki Enerji	100%	Aksa Elektrik	Turkey	n.d.
9-Aug-10	Bogazici Elektrik	100%	Is-Kaya & MMKEA	Turkey	2,990
9-Aug-10	Gediz Elektrik	100%	Is-Kaya & MMKEA	Turkey	1,920
9-Aug-10	Trakya Elektrik	100%	Aksa Elektrik	Turkey	622
9-Aug-10	Dicle Elektrik	100%	Karavil-Ceylan JV	Turkey	228
10-Aug-10	Nisan Enerji	50%	Boydak Enerji	Turkey	n.d.
16-Aug-10	Baskentgaz	80%	MMKEA	Turkey	1,211
10-Sep-10	Dogal Elektrik	80%	Hamza Dogan	Turkey	n.d.
21-Sep-10	Muradiye Elektrik	70%	Boydak Enerji	Turkey	n.d.
29-Sep-10	Enbati Elektrik	100%	Kardemir	Turkey	13
4-Oct-10	Altek Alarko	50%	Alsim Alarko	Turkey	n.d.
8-Oct-10	Ayas Enerji	51%	Oyak Group	Turkey	n.d.
1-Dec-10	Entek Elektrik	50%	AES	United States	136
6-Dec-10	Damla Su Enerji	85%	Ergun Bal	Turkey	n.d.
6-Dec-10	Kudret Enerji	90%	Nuh Enerji	Turkey	n.d.
6-Dec-10	Pamuk Elektrik	100%	Nuh Enerji	Turkey	n.d.
7-Dec-10	Anadolu Yakasi Elektrik	100%	MMKEA	Turkey	1,813
7-Dec-10	Toroslar Elektrik	100%	Yildizlar SSS Holding	Turkey	2,075
7-Dec-10	Akdeniz Elektrik	100%	Park Holding	Turkey	1,165
Total					**≈15,500***

n.d.: not disclosed
*: Includes estimated deal value for undisclosed deals

The mega deal on the gas distribution front was the privatisation of Başkentgaz, which supplied 2.1bn m³ gas (2009 statistics) to 1.2 million consumers in Ankara in 2009. The highest bid of US$1.2bn was again submitted by MMEKA, which undersigned a total value of US$7.9bn together with its winning bids in power distribution tenders.

These significant bid values and fierce competition during tenders can be considered a signal for the market to return to normal. But it is definitely a *new normal*, simply because what the markets went through over the past two years has redefined the way deals are engineered. Although the financial markets have recovered, debt financing is still harder to secure than it was before the crisis, and investments require more equity. In addition, the recent decision by the Competition Authority is already giving signs that the process for securing financing will be insufficient for the closing.

Oil and Gas: back to life

Renewal of c. 7,500 dealership contracts has already caused a stir

In contrast to the silence in 2009, activity in the oil and gas arena was louder in 2010; raising the share of related deals in total deal value from 3% in 2009 to 10% in 2010. The largest contribution to this came from the finalisation of the long-awaited Petrol Ofisi-OMV deal, in which OMV increased its share in Petrol Ofisi to 95.75%. The deal value of US$1.4bn has re-energised the fuel retail segment, which had until then been in virtual hibernation. This transaction also derives significance from the shift of market leadership from the hands of a local group to those of a global one.

The long-term contraction in the bulk and cylinder LPG segments led to a transaction between an LPG retailer and fuel retailer, with Milangaz, the third-largest LPG retailer, acquiring 70% shares in M Oil, a mid-sized fuel retailer. With probably similar motivation, an intra-LPG market deal occurred in the form of the total acquisition of Exengaz by İpragaz.

More important than the transactions, however has been the Competition Authority's decision to limit the duration of the usufructs and rental contracts between distributors and dealers to five years, on the grounds that these long-term contracts forced the dealers into exclusive supply contract extension, thereby having a foreclosure effect on the market. The retroactive character of this decision – and therefore its provisions relating to contracts enacted prior to this date – have already engraved 2010 on the market's mind.

Despite widespread expectations the existing regulatory measures, such as the minimum sale amount or financial requirements, which do not positively discriminate against small players have not yet resulted in consolidation of the market. However, the reshuffling caused by this change in dealership contract terms is rewriting the market scenarios: The significant decrease in upfront payments and investments by distributors is coupled with reducing margins, used as a negotiation tool in contract renewals with dealers. With the recent open call by the government to market players, asking them to align their margins with the European average, the result is now much closer to consolidation for survival in this segment.

Figure 4: Oil and Gas Deals in 2010

Date Announced	Target	Stakes in %	Acquirer	Acquirer Nationality	Deal Value US$mn
21-Apr-10	ExenGaz	100%	Ipragaz	Turkey	67
5-May-10	Amity Oil and Zorlu Petrogas	100%	TransAtlantic	United States	97
18-Jun-10	M Oil	70%	Milangaz Petrol	Turkey	n.d.
2-Aug-10	Aves - S-Oil JV	75%	NuStar	United States	n.d.
23-Oct-10	Petrol Ofisi	54%	OMV	Austria	1,390
Total					**≈ 1,700***

n.d.: not disclosed
*: Includes estimated deal value for undisclosed deals

Last year we predicted that the strict EMRA enforcement related to the National Stock Requirements and scarcity of land for greenfield investments would end in transactions in the storage market. The acquisition of 75% shares in Aves Soil J.V. by American logistics company NuStar confirmed this prediction, setting an example for future transactions in this strategic segment.

Albeit not yet reflected to reserve or production growth, there has been a significant increase in the number of foreign E&P companies operating in Turkey over recent years. There were only four domestic and 17 foreign licensees in 2002, but these figures reached 24 and 24 respectively in 2009. Meanwhile, the share of private capital expenditure in total E&P investment hit 49% in 2009, at US$350mn. The acquisition of Amity Oil and Zorlu Petrogas in 2010 by the American company Transatlantic Petroleum, which was already operating in the Turkish E&P market, contributed to this picture.

Looking ahead

The upcoming year will feature several different themes that echo the key motifs of previous years in the Turkish energy market, but within the rules of the new normal: steady growth in demand versus the extended break in uncertainty, coupled with more scarce credit creation. Within this framework, the closing of recent utility tenders, i.e. the seamless payment of US$13.5bn, will be at the top of our watch list.

At the same time, we will be eyeing the long-awaited privatisation of the state electricity generation portfolios. As to the public insight so far, the four thermal PPs (Hamitabat, Soma, Çan and Seyitömer) are to be tendered first, to be followed by nine portfolios before the end of 2012. These transactions will mean an additional 16 GW to private portfolios, pushing their current share in the installed capacity of c. 20% to c. 50% in two years. Higher foreign interest is expected, despite the recent picture in the distribution tenders; however the opaque regulatory scene represents a major caveat for educated and risk-averse investors.

We predict to see a sustained share for thermal PPs in private deals looking forward. Our fading expectations for a higher and more diversified feed-in tariff structure for renewables have been reshuffled with the ratification of the amendments to the Renewable Energy Law just before the year end, although the new tariff levels are far from pleasing the investors. The positive signals regarding the finalisation of the delayed process in WPP licensing, on the other hand, sows hopes for a more lively deal environment; the licences will be granted via tenders among existing applicants and no new licences will be issued until EMRA opens a new round, which is a very improbable.

On the gas distribution front, the upside of the coming privatisation of İGDAŞ is illustrated by the predicted higher foreign interest, in addition to fierce domestic competition for this company, which serves c. 4.5mn customers in Istanbul.

Our 2011 market tracking list puts special emphasis on the oil and gas market. Despite the pending amendments to Petroleum Law No. 6326, we have become accustomed to seeing deals in the E&P segment, largely from foreign companies on the back of the fact that 80% of onshore and almost all offshore reserves remain untapped. Accordingly, it would not be unduly optimistic to expect new deals in 2011.

Going down through the oil value chain, we feel comfortable reiterating our prediction last year about the heating up of the deal environment in the storage segment, in response to strict enforcement of the national storage requirements and the land scarcity for greenfield investments.

The usufructs issue on everyone's lips is inevitably transforming the way of doing business in the fuel distribution and retail segments. The astronomical upfront payments for long-term contracts are already a thing of the past, and dealers end up with higher leverage during negotiations, meaning lower margins for distributors. Consolidation among the mid and small-size distributors to create the necessary economies of scale for survival would be a deal base in 2011. One question is why distributors are not going for COCOs. Although the apparent reason is the 15% limitation for self-owned stations, the underlying factor is high investment need due to scarcity and high cost of available land. Nevertheless, even exhausting this small space will become more appealing and constitute another justification for consolidation.

All in all, we admit that it will be hard to match 2010 in terms of both deal number and value, since the tender schedule for the electricity generation assets already spans the coming two years. Nevertheless, on the back of the stated expectations it is still realistic to anticipate strong deal prospects in 2011.

2010 was certainly a hard act to follow, but the upcoming privatisation of electricity generation assets means expectations for a strong deal market remain high

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