Due Diligence Lessons Learned

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Global Presence Local Solutions
Variety of Circumstances for Due Diligence Review

- Purchase of commercial utility
- Sale of commercial utility
- Lender’s due diligence
- Public-Private Partnerships, with a wide variety of deal structures, e.g.
  - Design-Build-Own-Operate-Maintain (DBOOM)
  - Design-Build-Own-Operate-Transfer (DBOOT)
  - Design-Build-Finance-Operate-Maintain (DBFOM)
Due Diligence Lessons Learned

• Market analysis
• Customer contract analysis
• Plant and distribution system CAPEX analysis
• Operating costs and metrics analysis
• Financial analysis
• Regulatory risk analysis
• Country risk analysis
Due Diligence Lessons Learned

Market Analysis
Market Analysis

• Don’t accept the seller’s market assessment

• District energy market growth is directly related to the real estate market

• Talk to independent market resources
  – Engineering consultants
  – Ex-employees of target and/or competitors

• Be conservative when converting real estate growth into district cooling capacity growth

• Take into account competition from other district energy utilities and developer’s choice to not outsource

• Growth assessment may have a major impact on valuation

• Don’t be afraid to apply a conservative view
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Customer Contract Analysis
Customer Contract Analysis

• Key non-legal issues
  – How much time is left before contract expiration?
  – How can the contract be extended or renewed? Is there any transfer language?
  – Does the contract contain any variable price risk to the target?
  – How can contract prices be adjusted? Is there a track record of price adjustments?
  – How can the contact be assigned?
  – Can the contract be terminated for other than non-performance issues?
  – Is contract capacity specified? Are performance metrics specified and are they being met?
  – Does the contract contain any buyout or transfer option?
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Plant & Distribution

CAPEX Analysis
Plant & Distribution CAPEX

• Projecting future capital investment
  – Use current actual and/or updated estimated cost per unit of installed capacity
  – Historical costs can be significantly skewed based on the ebb and flow of the markets for contracting, equipment and materials

• Understand the CAPEX difference between all new plant and distribution system and expansion of existing system

• Verify that CAPEX for planned distribution system expansions is sufficient given system hydraulics

• How does contracted load compare to
  – Actual peak load?
  – Installed capacity?

• What CAPEX investments will be required under any BOOM/BOOT deals?
Plant & Distribution CAPEX, cont.

• What are the ages and conditions of existing assets? What are the estimated remaining service lives?

• Will poor Delta T constrain achieving full capacity of plant and distribution assets?

• How much maintenance CAPEX is being spent and what is the trend?

• Beware simplified estimates of distribution system expansion
  – Trench feet per unit of capacity sold
  – Distribution system design and specs consistent with expected service life
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Operating Costs & Metrics Analysis
Operating Costs & Metrics Analysis

• What is the gross margin? What is the trend and why?

• How will margins be affected by
  – Load growth?
  – Load shrinkage due to efficiency measures?

• What are the trends in production efficiencies (fuel, electricity, water)?

• What are the opportunities for efficiency improvement?

• What is the outlook for prices of production inputs?

• What do outage records tell you about the O&M practices?

• How much is spent on asset maintenance and what is the trend?

• Is there a good water treatment program?

• Are risks and rewards for Key Performance Indicators (KPIs) well-aligned?
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Regulatory Risk Analysis
Regulatory Risk Analysis

• What are the terms of air and water permits and when are they up for renewal? Will they accommodate envisioned growth?

• What is the vulnerability to (or potential competitive advantages of) carbon regulation?

• What is the current status of district energy regulation affecting the target?

• Are there regulatory changes anticipated? Do any of these include price regulation?
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Financial Analysis
Financial Analysis

• Debt
  – How is it structured?
  – What is the security?

• Receivables
  – What is the average receivables period?

• What are vulnerabilities to non-renewal of BOO/BOOT deals?

• Is variable revenue covering
  – Variable costs?
  – Some fixed costs?

• Cash flow vs. income
Due Diligence Lessons Learned

Country Risk Analysis
Country Risk Analysis

• Rigorously assess country risk

• Country risk is different for international buyers than for regional buyers
Final Thought

• Would you rather see your client
  – Bid fairly and lose, or
  – Win and find out three years later that they overpaid based on your assessment and are **not** happy?
Thanks for your attention!

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