



Plugged In: Beyond the tipping point

How new players in the P&U industry are changing the rules—and your business model

In this edition of KPMG Global Energy Institute's Plugged In, we asked Michael Hoyt and Bruce DeMyer from our Tax team to discuss how new players in the P&U industry are changing the rules and business models. The digitization of our daily lives means that just about everything requires electricity in some form. The result is that a new relationship is evolving between consumers and providers.

Describe the P&U industry and how it is evolving.

Over the past few years, we've seen a proliferation of renewable energy sources, the adoption of electric vehicles (EV), and the shuttering of coal-fired plants. Until fairly recently, renewables were not perceived as game changing, but their adoption has grown rapidly, both domestically and overseas, and the industry is finding more creative ways to incorporate them. Market forces have pushed renewables into the mainstream, and this subset of the industry is now at an inflection point where it is in the ascent (growth) stage of its lifecycle. Meanwhile, traditional utilities are expanding their operations through acquisitions, strategic joint ventures, and evaluation of tax equity investment.

What's pushing the industry beyond that tipping point?

Power & Utilities (P&U) (including electricity, natural gas, and water companies) are now competing with new players from outside the traditional P&U industry. For example, tech companies like Tesla, Google, and Yahoo are influencing the use of renewables and how we consume energy. In addition, large oil and gas companies as well as private equity firms are among those seeking to carve out their piece of the proverbial pie in a growing renewables market. These companies are often entering the market at the urging of activist investors or based on a desire to be part of the green economy. Like the regulated utilities, these new entrants bring large balance sheets to these transactions.

An increase in oil prices helped lift electricity prices, which allowed some utilities, private equities as well as opportunistic investors to take advantage of tax credits and better market spreads. Watching the market make this shift makes us bullish on what we can expect from an acquisition-focused culture and private equity funds going forward.

In addition, the auto industry is evolving as more EV options are introduced and adopted by consumers, which is driving the development of charging infrastructure. Aside from influencing consumption, these companies may also eventually get into electricity generation. All in all, a score of nontraditional power companies are now influencing the P&U business model.

With the PTC sunset and the reduction in the corporate tax rate, what is the profile of an acquirer of wind farms?

Assuming the federal tax subsidies for wind farms sunset as scheduled, the tax appetite of acquirers will change along with the expected returns on these assets. These two elements of these assets' valuation (tax subsidies and expected returns) will result in the emergence of a different set of buyers—those that may not be driven solely by tax credits, but are attracted to infrastructure. If we set aside Congress's potential to revisit PTCs or some other incentives, the new buyers of mature wind farm and solar assets will be investors seeking debt-like returns and a stream of contracted (expected) revenue—they may be agnostic to the tax incentives. Likely buyers include utilities, infrastructure funds, and pension funds.

As acquisitions change the landscape, utilities are trying to figure out where they will play. We're seeing an expansion of electrical vehicle fleets as well as governments switching from gasoline to natural gas or battery-powered buses and infrastructure vehicles.

With the ever-increasing electrification of homes and cars, how do you think utilities will respond?

We see room for new and nontraditional entrants into the space, as consumers become more energy agnostic—meaning they are not as concerned with receiving electricity from “traditional” providers and are more focused on bundled services and excellence in customer experience. However, the proliferation of distributed energy resources has cut into traditional retail and commercial/industrial demand. To add another layer of complexity, individual corporations are establishing renewable energy goals by indicating their intention to rely increasingly on electricity generated from nonfossil fuel sources.

With the lack of a unifying federal mandate for renewables, individual states have taken differing stances on how quickly they may adopt renewables and issued state-specific legislation. We expect varied responses from the utilities, given the pressures of nontraditional competitors, energy agnostic customers and distributed energy resources. We believe the utilities' leaders are savvy and are evolving in light of a crowded and diverse marketplace. In this environment, We would expect an increased opportunity for acquisitions by utilities of companies that are specializing in these new areas.

We also expect utilities to become more aggressive about rate-basing renewables, which will allow them to marry the wave of data analytics flowing from smart meters and to retain a continued relevance in the delivery of electricity. These developments will come with their own challenges as the main tax incentive for solar (the

Investment Tax Credit) is required to be normalized. As a result, we are likely to continue to see a number of tax equity structures survive in the solar space even as utilities increase their tax appetite (and this credit has the longest time until sunset).

Lastly, we expect utilities to become more creative with respect to joint ventures with a variety of existing players as well as the increasing number of new entrants to the market. Such arrangements will allow utilities to maintain their central position in the future generation, transmission and distribution of electricity.

What do these developments mean for how energy is delivered and consumed?

Over last few years, there's been a shift in how people are consuming or having electricity delivered. We see community providers, stand-alones, and independent facilities. Big-box retailers are putting solar farms on their roof space to defer costs. Corporations are setting deadlines for when they want all their power to be from renewable sources. The fully connected home is playing a big role in how and where we source our electricity. The shift is driven by smart technologies that will likely drive greater demand for electricity, which ultimately will result in more new providers and less loyalty to traditional providers.

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