The splintering of European utilities

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Norway’s Statoil announced last week that it will fence off its renewables activities, in a new unit called New Energy Solutions (NES). The announcement comes about a month after German utility E.ON decided to separate its power and renewables businesses.

The decisions aren’t coincidental. European utilities are concluding that renewables and conventional power are no longer suited to coexist peacefully within a single utility. The results of first quarter 2015 earnings, which multiple European utilities released last week, seem to confirm this interpretation.

Germany's RWE blamed an overall shortfall in its first quarter earnings on a “continued drop in margins” in conventional electricity generation. RWE's EBITDA declined by 3% to €2.2 billion ($2.5 billion) from Q1 2014 to Q1 2015, and the operating result fell by 5% to €1.6 billion over that period.

In contrast, RWE’s clean energy earnings, under its Innogy renewables subsidiary, posted substantial growth in the first three months of this year. RWE Innogy improved its operating result by 56% over the first quarter of 2014, to €151 million from €91 million, thanks to the initiation of new renewables plants – primarily wind. "These investments are increasingly paying off," said Peter Terium, chief executive of RWE, on the earnings call.

Standalone businesses

E.ON was the first – publicly, at least – to begin efforts to divide power and renewables into standalone businesses. It may have been planning the shift long before the announcement, however, as it has sold much of its fleet of conventional assets over the past year.

E.ON wants to break off traditional oil & gas activities completely, and is aiming to be a dedicated clean energy business by next year. E.ON will then focus on renewables, energy networks, and customer solutions. A new spinoff company, Uniper, will operate E.ON's existing conventional energy business, which consists of hydro and other traditional generation, and global energy trading.

Statoil, meanwhile, opted to splinter off its renewables unit. Statoil is an established offshore wind player, and expects its portfolio of offshore assets - including the in-construction £1.5 billion ($2.5 billion) Dudgeon offshore wind farm in the UK - to form the basis of NES. But Statoil expects the NES portfolio to grow to also encompass other renewables fuels.

More breakups may follow. The UK's Centrica, for example, is conducting a strategic review of its businesses, and there has been persistent talk of a similar division.

“Utilities simply can no longer operate as they are used to,” the European project finance head at one German bank told *IJGlobal*. “Their ratings and balance sheets are under pressure, and they are having to adjust their mind-set, and the way they operate their traditional baseload business as a result.”

Conventional power increasingly unused

Utilities are looking to deleverage their balance sheets, and selling off underperforming conventional assets would free up capital to invest in renewables ventures.

But conventional asset sales are not bringing in the returns that utilities are seeking. Centrica struggled to sell the three combined-cycle assets that it put up for sale late last year, and eventually abandoned the process.

In March 2015 E.ON sold a 3.3GW portfolio of Spanish and Portuguese hydro, coal-fired and combined-cycle gas-fired plants to a consortium of Macquarie and Wren House. “E.ON took a huge hit on it,” said a banker familiar with the sale. “The price utilities can receive for conventional assets is far lower than other energy assets that have sold recently, like distribution grids.”

Only 1.3GW of the former E.ON portfolio is expected to contribute to future cashflows. Several of the gas-fired assets are not running due to low demand and overcapacity in the Spanish market.

European Union-instigated carbon reduction demands and renewables-subsidy regimes in several local markets are contributing to the struggle of conventional power, and are perhaps spurring the utilities to divide conventional power from renewables. While renewables projects flourish under subsidies and priority to the grid, conventional plants are increasingly unneeded, and often go unused for long stretches.