Australia served one of the biggest PE deal in its history – Brookfield and EIG in for Origin Energy in a $11.8bn deal

Introduction

On November 10th 2022, Origin Energy Ltd. [ASX : ORG], received and backed an $11.8bn takeover bid from a consortium led by Canada's Brookfield Asset Management [NYSE : BAM] and private equity firm EIG Global Energy Partners. The business is to be split up, with Brookfield acquiring the retail and energy supply business, whilst EIG will take over the company's gas operations and its stake in the Australia Pacific LNG project. The $9-a-share bid offers an astounding 55% premium on Origin Energy's stock price and, if successful, the takeover would rank as one of the biggest private equity-backed buyouts of an Australian company and would be the largest deal in the country this year.

About Brookfield

Brookfield Asset Management is one of the biggest alternative investment management funds in the world, with more than $725bn in assets under management and 150 000 operating employees. Headquartered in Toronto, it focuses on direct control investments in infrastructure, renewable energy, and real estate. Brookfield recently signed a deal in August with Intel [NASDAQ : INTC] to fund its chip-making factory expansions in Chandler, Arizona.

The bid for Origin Energy was made through the Brookfield Global Transition Fund, co-run by the former governor of the Bank of England, Mark Carney, that had raised $15bn throughout this year. It is the world's largest private fund dedicated to facilitating the global transition to a net-zero carbon economy and has already deployed investments in a UK battery storage power provider, as well as German and US solar power and battery developers. Interestingly, Brookfield attempted a takeover of AGL, one of Origin Energy's largest competitors, before building a stake in the business in the last year.

About EIG

Established in 1982, EIG Global Energy Partners is an institutional investor in the energy sector specialising in private investments in energy and energy-related infrastructure on a global scale. Headquartered in Washington D.C., it typically invests in hybrid debt or structured equity securities with a minimum commitment of $100m to a single project or company. As of March 2022, EIG has $25bn invested across 380 portfolio companies in 38 countries across the globe.

EIG has a three-pronged approach to its business strategy comprising of energy funds, credit/direct lending and Harbour Energy Ltd. The company's energy funds target directly negotiated private transactions with mid- and large-cap energy companies and projects. It places an emphasis on transactions underpinned by hard assets such as proven oil & gas reserves, pipelines, processing facilities, liquefied natural gas terminals and power plants. EIG's credit/direct lending vehicles provide senior and high yield loans to targeted project finance instruments with a higher credit quality. Its competitive advantage comes from the ability to provide longer-term debt, given that many energy and infrastructure assets have long useful lives and often are characterised by stable, contracted cash flows.

Finally, Energy Harbour Ltd. is a global oil and gas company founded by EIG, operating at the confluence of three major trends in the energy industry: new supply sources, changing trade patterns and changes in the commodity trading industry causing a decline in traditional financial intermediaries and the rise of independent physical energy trading houses. Unlike most of the private equity backed companies, Harbour is funded with permanent capital with the goal of building a growing global portfolio of long-term oil and gas businesses. Harbour completed its first acquisition of a $3bn package of producing assets operating in the North Sea in 2017.

About Origin

Formed in 2000, following a demerger of the Australian conglomerate Boral Limited, Origin Energy is a liquefied natural gas (LNG) developer and a vertically integrated energy company headquartered in Sydney, Australia. Origin operates Australia's largest coal-fired power station at Lake Macquarie, whilst also producing power from wind, pumped water storage and solar with a total capacity of over 6 GW. Its generation portfolio, including baseload, intermediate and peaking electricity, is one of the largest in the national energy market.

Origin Energy's retail business serves over 4 million customers, encompassing both large businesses, as well as small households, making them Australia's biggest energy retailer. Its two biggest competitors, AGL Energy and EnergyAustralia, serve 3.7 million and 1.7 million customers respectively. Origin Energy reported a statutory profit of -$1.4bn in 2022, likely because of volatile gas and electricity prices leading to significantly higher hedging costs. In the same year it announced an underlying EBITDA of $2.1bn and a free cash flow of $1bn, indictors Origin claim to be a better reflection of the company's performance.

Deal Rationale

The bid awards a 55% premium on Origin Energy's share price, leaving some analysts scratching their heads over the value that the consortium sees in the business. We see two underlying reasons that explain the high premium expressed in this bid: a bet on the fact that gas is essential in the energy transition to renewable energy and the potential for growth in Australia's clean energy sector.

The primary reasoning behind EIG's bid to take over Origin Energy is based around a single bet: the world will need gas to stabilise the transition from fossil fuels to renewables. The Australian government's landmark Climate Change Act passed the Senate in September, ensuring that Australia's net zero emissions target by 2050 will be brought into legislation. In the meantime, fossil fuels are set to play a crucial role in facilitating the transition to clean energy, as they have the power to stabilise prices in the energy market by providing peaking power during periods of high demand. Blair Thomas, chairman of EIG Partners, said: "People need to recognise that this is a transition, and that gas is the key fuel to make it happen. So, it's in everybody's interest that we provide security and price stability – otherwise, there's a real risk that the public turns on decarbonisation, and then we're all losers."

Origin Energy is showing for growth in the clean energy sector, too. If the bid is successful, Brookfield have pledged an additional $20bn by 2030 to fund Origin Energy's transition plan to clean energy by building renewable energy capacity and storage. Brookfield's Asia Pacific Chief Executive Officer said in a statement: "Together, Brookfield and Origin can support Australia's multi-decade transition journey and accelerate our progress towards its emissions-reductions targets" and claimed that the energy transition in Australia is a "once-in-a-generation" investment opportunity whilst still recognising that a lot of investment will be required to meet Australia's legislated climate goals.

Origin's market presence and strong management team, combined with Brookfield's capital injection and renewable power development expertise, can produce powerful synergies to its clean energy business. Brookfield plan to position Origin as the 'leading greentailer', by building the required renewable storage facilities. Origin Energy presents both firms a unique opportunity to enter the Australian energy market. The recent strength of the

US dollar, which has risen 14% against the Australian dollar since March, has created a window of opportunity to acquire Australian assets at a discount, according to Mr Thomas. Brookfield had already made an unsuccessful bid for AGL Energy as an attempt to enter the Australian energy market.

Deal Structure

The planned transaction features a joint takeover bid of A$18.4bn ($11.8bn) by Brookfield Asset Management [BAM : NYSE] and EIG Global Energy Partners for Origin Energy [ORG : ASX]. At A$9 per share ($5.77) the bid presents a 55% premium on Origin's share price the day before the offer was revealed. This would value Origin's equity at A$15.45bn ($9.91bn) and the remaining A$2.95bn reflecting the company's debt. Following the announcement, Origin's stock jumped 35% to A$7.90, showing investor optimism in the prospects of the deal.

This is the 3rd bid for Origin since August by the Brookfield-EIG consortium after their August and September bids were rebuffed and requires approval of Origin's shareholders. The original bid on August 8th contained an offer of A$7.95 per share (37% premium) and the latter, made on 18th September, of A$8.70 (50% premium). The Origin board of directors stated that it is their intention "to unanimously recommend the shareholders vote in favour of the proposal, in absence of a superior proposal.". Origin expects due diligence to complete in eight weeks and has granted the consortium a roughly five-week period of exclusivity, subject to multiple conditions.

Outlook for Brookfield

Brookfield, through its Global Transition Fund, has had an eye out for the energy industry in Australia this year, acquiring Australian electricity and gas distribution company AusNet for A$10.2bn ($7.7bn). In addition, it had tried to acquire Australia's top power producer, AGL Energy, with a $3.5bn takeover offer which was subsequently rejected by the AGL board stating that the proposal had "undervalued the business". The failed deal still resulted in Brookfield's acquisition of a 2.5% (A$200m) stake in AGL Energy, with the company purchasing 17.2m shares in June.

Companies such as AGL and Origin are said to have lost their "utility" status as public companies due to the investment needed to switch from fossil fuels to renewable energy sources. This comes alongside Australia's requirement of at least A$80bn of investment in its energy market to hit its 2030 climate reduction targets. Hopefully the much-needed cash injection from Brookfield will see a fast-paced transition towards renewable energy in the future and the discontinuation of Origin's coal fired power plant by 2025. Brookfield may see growth opportunities with Origin's plant, which accounts for almost half of Origin's generation capacity, and likely wishes to add it to their portfolio as a part of their extensive global infrastructure investments.

Despite the positive outlook and strong prospective financial backing from Brookfield, there are regulatory concerns about its existing ownership of Australian electricity networks through some of its funds. The deal requires Australian Competition and Consumer Commission (ACCC) and Foreign Investment Review Board (FIRB) approval to proceed. One of the barriers to approval lies in the mentioned acquisition of AusNet, which owns more than A$11bn of electricity and gas network assets throughout Australia. AusNet controls most of the energy distribution for the 2nd most populous state in Australia (Victoria) and over 20% of their 737 000 customers have purchased solar panels, making it one of the largest C&I solar companies in Australia. However, due to Australia's desire to quickly undergo an energy transition, as well as Brookfield's pre-existing presence in the Australian renewable market, it seems likely that regulatory approval will occur.

In addition to this regulatory hurdle, Origin has been working on a bid for Partners Group's CWP Renewables, the biggest ever renewables portfolio up for grabs in Australia. The portfolio is likely worth more than A$4 billion, with 1.5 GW of wind/solar assets operational or under-construction, and an optimistic forecast of 18 GW by 2040. This six-month auction is due to end at the end of November. Given that Brookfield/EIG's offer hasn't stopped Origin from bidding for CWP, Brookfield will want to know all about the prospective deal as part of their due diligence before it causes even more challenges.

Overall, it seems that Brookfield seeks to profit greatly from this deal and is willing to heavily invest in the Australian renewable energy transition but may suffer under a potential deal signing between Origin and CWP.

Outlook for EIG

EIG Global Energy Partners wishes to take over Origin's exploration and production segments, as well as its integrated gas business, which includes Origin's 27.5% stake in Australia Pacific LNG (APLNG). EIG will pursue this transaction through its LNG specialised subsidiary, MidOcean, which recently paid $2.15 bn for Tokyo Gas's stake in four Australian integrated LNG projects. EIG plans to embed Origin's integrated gas business into the four projects to supply natural gas to both domestic and global markets.

The bid comes at the same time in which the Australian government is considering imposing price caps on gas to relieve the pressure of soaring energy prices from consumers and manufacturers. This, however, may incentivise the future holder of Origin's gas assets and other Australian natural gas companies to sell abroad to nearby LNG importing countries, such as China and Japan, which may lead to a net fall of energy availability in Australia.

In addition, a risk for EIG in its bid for Origin is a multibillion-dollar claim made by Tri-Star Group against Origin's APLNG over rights to certain coal-seam gas assets and royalties. The claim pertains to approximately 20% of APLNG's proved and probable reserves, according to Origin's 2022 annual report. This may prove damaging to the future realisable assets held by EIG through Origin's APLNG.

Overall, EIG will strengthen its ownership of the Australian LNG industry through its subsidiary, MidOcean, and will likely profit from high gas prices both locally and globally.

Outlook for Origin

The timing of the deal is a challenging one for Origin. Global energy markets are constantly changing, the Australian energy industry is bruised after a crisis in its electricity trading spot market, and there are fears of a gas price cap. Is it the right time for its shareholders to cash out and enable Australia's biggest PE backed buyout or should the company play the long game and perhaps realize more of this year's record underlying profits?

If the deal goes through, the company will likely continue the energy transition it has embarked on over the last years, with Brookfield facilitating its speedy execution, especially with the A$20bn capital the company has pledged, which would have been difficult to raise otherwise. In addition, it follows an ongoing trend of consolidation in the Australian energy market this year where Woodside Petroleum merged with BHP's oil and gas business, and Santos merged with rival Oil search in a A$21bn deal last year.

The Australian energy market, in particular on the east coast, has struggled throughout 2022 with fuel supply shortages and unusually high electricity spot prices. Heavy rains and geological issues have slowed down coal production significantly, to the point where it caused a A$692m reduction in Origin's electricity gross profit. Should these climate related issues persist, coal may continue to generate large losses for Origin and will likely affect the over 2 million people Origin's Eraring coal power station services.

Not only coal has suffered, but wind and solar have not been able to cope with the shift in demand, as Australia is experiencing cyclically low wind and solar production. This volatile and unpredictable environment will probably see Origin respond with a fresh ownership and a splitting of its operations.

Overall, Origin has recently been struggling with electricity markets and geological issues and will likely see the deal going through. The deal would see the energy markets segment go to Brookfield's to see a rapid restructuring, whereas gas will be taken under the arm of EIG's MidOcean, expanding its global consumer profile.

Summary

With the ongoing volatility in global energy markets, and Australia's commitment to net-zero by 2050, this probably marks yet another multibillion-dollar energy deal in 2022. The deal, if successful, would be the largest ever private equity-backed buyout in Australia, surpassing Blackstone's $6.3nn acquisition of Crown Resorts Ltd in June 2022.

Australian companies are deciding to consolidate, coal is losing viability and renewable energy's intermittent nature is showing. With complex deals in 2022, Australia is seeing a complete remake of its energy industry. This begs the question; will the country get back from being down under the weather?

TAGS: Brookfield, EIG, Origin Energy, Australia, net zero, energy, private equity