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M&A Accounting and Tax Considerations

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Agenda

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market overview

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Matt Nelson &
Brian Boufarah

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Tim Wilhelmy

Alternative Energy M&A Market Overview



Key Market Activity Drivers

- Expiring tax credits led to increased development / construction activity in last few years
- In construction wind projects need to be completed/fully financed by end of 2015
- Distributed solar generation projects getting mainstream
- Developers seeking cash to complete construction projects and looking to take some money off the table / cash in
- Infrastructure and utility investors continue to like the long term steady returns of renewable assets

Future Considerations

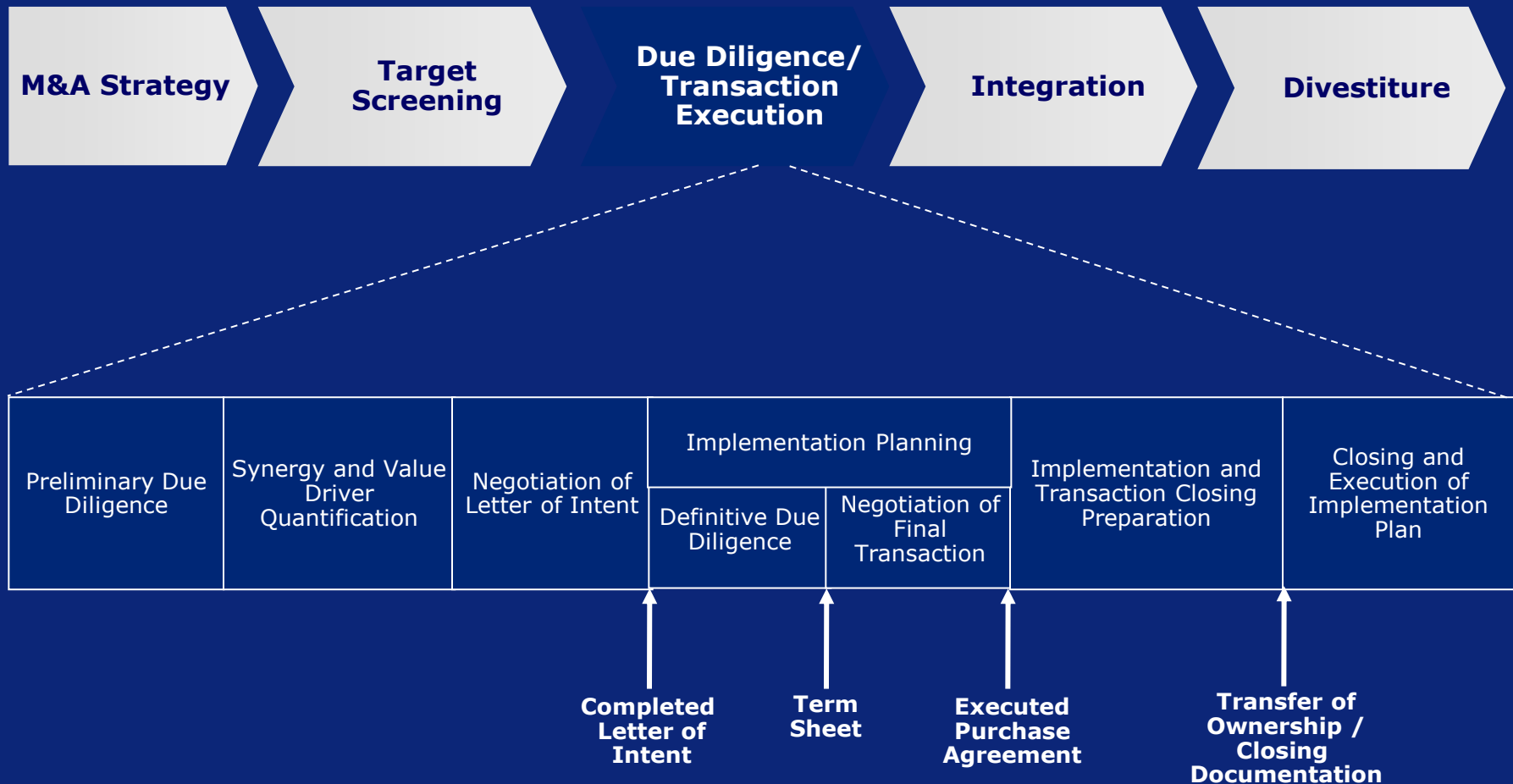
- National energy policy
- State renewable energy mandates
- Potential for feed-in tariffs and / or easier access to long-term power purchase agreements
- Interest rates relative to ability for projects to create / return stable cash flows
- Continued increase in capital deployment to US Infrastructure investments (as a key investment strategy for many non-US players)
- Continued development of new projects to expand overall renewable energy capacity

High Level M&A Transaction Considerations



Transaction Execution and Buy-Side Due Diligence

A properly structured and well managed transaction process mitigates execution risk and expedites closing.



Financial & Tax Due Diligence – Determining Scope

- Complexity of target
- Complexity of deal, e.g., joint venture, taxable vs. tax free, asset vs. stock, carve-out of a division, etc.
- Whether target is public or private
- Timing & deal stage
 - Auction or exclusivity
 - Early phase or is fully committed bid required
 - Strategic transactions – materiality considerations
- Integration plans

Financial Diligence – Sample Procedures

- Interview knowledgeable company personnel (e.g., controller, CFO, etc.)
- Review audit working papers and interview external auditors
- Request and analyze detailed information on the target
- Examine the target's historical normalized earnings
- Examine and understand the target's historical cash flows and future non-operating cash flows
- Examine the target's future potential exposures
- Understand target's corporate structure and business model
- Review significant legal agreements and acquisition/disposition history to determine exposures
- Evaluate impact on financial statement reporting
- Comment on proposed purchase agreements and other legal agreements related to the proposed acquisition

Tax Diligence – Sample Procedures

- Understand target's corporate structure and business model
- Interview knowledgeable company personnel (i.e., tax experts)
- Read tax returns and interview tax advisors
- Evaluate and quantify historical tax position and exposures for income tax, gross receipts or sales tax, withholding, other taxes
- Develop structuring / integration opportunities and issues
- Assess tax implications to the investment model
- Quantify tax attributes (e.g., NOLs, tax basis, credits, etc) and any limitations on future use imposed by change-in-control
- Read significant historic legal agreements and acquisition / disposition history to determine exposures
- Comment on tax relevant provisions of proposed purchase agreements and other legal agreements related to the proposed acquisition

Transaction Execution Best Practices



Best Practices – Planning & Process

- 80:20 rule – “must have” vs. “nice to have”
- Establish clear and consistent process
- Select functional team participants that are “up-to-speed”
- Define regularly scheduled checkpoints to assess progress against milestones
- Utilize institutionalized learning – building on past success
- Conduct thorough due diligence and link it to other M&A activities
- Streamline reporting to focus on key issues from internal teams and external advisors
- Integrate results into negotiation strategy and integration planning

Best Practices – Process Efficiency

- Set deal goals and objectives focused on strategy
- Focus on the most critical transaction elements
- Maintain control through setting milestones, benchmarks and deadlines
- Establish clear team roles, responsibilities and central command
- Coordinate information gathering and sharing
- One team approach with communication across teams and advisors
- Complete real time problem identification and resolution
- Translate due diligence findings into clear integration plans and objectives

Best Practices – Valuation

- Establish disciplined approach to strategic decision making, including accretion / dilution analysis, quantification of diligence findings and use of standard models
- Perform rigorous analysis of synergies to identify probable outcomes and the associated likelihood of achieving strategic value
- Consider structuring alternatives to improve the likelihood of achieving the expected strategic objectives and value
- Develop risk map
- Translate value into deal terms
- Avoid using the model to justify a pre-determined outcome
- Perform independent review

Lessons Learned From Private Equity / Financial Investors ...

- Execute deals with speed and efficiency for a competitive advantage
- Exercise patience and skill in courting targets
- Apply creativity to make the deal work (structures, financing partners, etc.)
- Enable flexibility in execution through reliance on outside experts
- Maintain financial discipline
- Leverage talent

Lessons Learned From Serial Strategic Investors

- Create a well defined structure for investigating and exploring new targets
- Maintain dedicated, high quality staff with rigorous processes are prepared to respond quickly to opportunities
- Assess capacity to integrate
- Hire, promote, and retain the highest caliber employees for the M&A group
- Establish disciplined approach to strategic decision making, including accretion/dilution analysis, quantification of diligence findings and use of standard models
- Perform rigorous analysis of synergies to identify probable outcomes and the associated likelihood of achieving strategic value

Lessons Learned From Serial Strategic Investors *(cont.)*

- Consider structuring alternatives to improve the likelihood of achieving the expected strategic objectives and value
- Develop risk map
- Translate value into deal terms
- Avoid using the model to justify a pre-determined outcome
- Perform an independent review of the target

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Deep Dive – Tax Due Diligence Considerations

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Tax Due Diligence – Identify Target

- Key tax due diligence considerations depend on:
 - Transaction type
 - Stock/interest purchase
 - Asset purchase
 - Classification of target entity
 - C-corporation/S-corporation
 - Partnership
 - LLC

Asset vs. Share/Interest Purchase

Taxable Asset Purchase

- Buyer's preference
- Buyer gets FMV tax basis in assets
- Historical liability stays with seller
- May increase structuring flexibility
- Usually a double level of tax for seller
- May be difficult to execute
- May incur additional transfer taxes

Taxable Stock Purchase

- Seller's preference (if transaction isn't tax-free)
- Usually single level of tax for seller unless a subsidiary of consolidated group
- Historical liability transfers to buyer
- Buyer gets carryover tax basis in assets
- Tax attributes generally carryover, subject to limitations
- Joint election can be made to obtain additional tax benefits resulting from a higher tax basis of assets for the buyer

Tax Due Diligence Focus Areas

1. Tax examination status
2. Tax history
3. Tax attributes
4. Tax reserves
5. State income taxes
6. Tax accounting methods
 - a) Depreciation
 - b) Repairs/maintenance
 - c) Inventory (e.g., indirect costs)

Tax Due Diligence Focus Areas

7. Non-income taxes

- a) Sales/use tax
- b) Employment/payroll tax
- c) Environmental taxes
- d) Transfer taxes
- e) Property tax (e.g., abatements, exemptions, PILOTs)
- f) Other (e.g., VAT, customs, excise taxes)

Tax Due Diligence Focus Areas

8. Tax basis considerations
9. Information reporting
10. Hedging activities (e.g., PPA, swaps, etc.)
11. Alternative energy credits / cash grants
12. Compensation and payroll
 - a) Golden parachutes, gross-ups and withholding
 - b) Independent contractors

Valuation Model Tax Considerations

1. Choice of entity
2. Cash flows and Flip dates in Tax Equity structures
3. Transaction costs (e.g., deductibility, tax vs. US GAAP)
4. Financing (e.g., deductibility of interest)
5. Anticipated cash and book effective tax rates
6. Cash tax expense
7. Taxable vs. carryover basis transactions
8. Tax amortization (e.g., goodwill)
9. MACRS and bonus depreciation
10. NOL and credit utilization
11. Prospective accounting method changes
12. Withholding taxes

Contract Considerations

1. Representations and warranties
2. Indemnity
3. Approvals
4. Transfer taxes
5. Foreign Investment in Real Property Tax Act (“FIRPTA”)
6. Golden parachute

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Deep Dive – Accounting Due Diligence Considerations

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Select Accounting Diligence Focus Areas

- HLBV Accounting Requirements
- Derivative transactions (risk management activities) and potential hedge accounting treatment
- Accounting for Purchase Power / Sales Agreements
- Lease accounting (consideration of EITF 01-8 and FAS 13)
- FIN 46R considerations
- Emission credits and other carbon considerations
- Regional independent system operator rules, interconnection agreements, billing true-ups
- Equity method investments and non-regulated operations
- Inventory – Appropriateness of levels, obsolescence

Select Accounting Diligence Focus Areas

- Depreciation – policy differences
- Purchase price allocation fair value estimates:
 - Intangible assets, including power purchase and fuel supply agreements
 - Debt
 - Non-regulated operations and equity method investments
 - Property, plant & equipment
 - Estimated impact of depreciation and amortization on reported earnings
- Capitalization policy / limits, treatment of capital spares inventory
- Accounting for major maintenance
- Allowance for doubtful accounts

Other Operational Diligence Focus Areas

- Related party transactions / transfer pricing
- Government grants
- Insurance considerations
- Impact of regional energy policy and expected developments (uniformity, competition), trading markets
- Corporate functions and overheads
- Regulatory environment (including rate base considerations)
- Collaterals and guarantees
- Production capacity and utilization
- Investment – growth and maintenance capital expenditures
- Potential for efficiency savings
- Regional power market
- Reliability of assets

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Yieldco Structures & IPO Considerations and Other M&A Accounting Considerations

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What is a Yieldco Structure?

- Has varying similarities to a Master Limited Partnership structure or a REIT, but generally in the form of a corporation
- Focused on distributing cash flows to investors
- Primarily renewable energy
- Revenue generally tied to long-term contracts (e.g., predictable source of cash flow)

Growing in Popularity

- Several Yieldco deals in the past 18 months
 - NRG
 - Pattern
 - NextEra
 - Abengoa
- Several more in the pipeline

What are the Advantages of Yieldco?

- Investor benefits
 - Offer an attractive yield
 - Distributions are generally paid quarterly and are highly reliable due to several features
 - Emphasis on fee-based or margin businesses
 - Relatively low direct commodity price risk
 - Emphasis on long-term contracts
 - Low maintenance capex requirements
 - The trading price of the units may appreciate

Common Success Factors for Addressing an IPO

Common success factors	Common steps to success
Effective planning and IPO management	<ul style="list-style-type: none">• Create a project plan• Proactively manage the process• Identity dedicated resources• Accountability
Complying with SEC filing requirements	<ul style="list-style-type: none">• Understand the SEC filing process• Anticipate financial reporting challenges
Implement strong financial reporting processes and systems	<ul style="list-style-type: none">• Corporate governance• Tax structure• Well documented internal processes• Effective IT systems and internal controls
Tax considerations	<ul style="list-style-type: none">• Availability of key financial data input• Determine operational structure of tax department

Financial Accounting and Reporting Matters



Preparing Financial Information to Include in a Yieldco Registration Statement

- Identification of entities and corresponding ownership percentages to be contributed
- Determination of Predecessor financial statements for inclusion in the Registration Statement (may be complex ~ consider pre-clearance with SEC)
- Include audited financial statements of the Predecessor for annual periods and unaudited interim financial statements for any stub periods

Preparing Financial Information to Include in a Yieldco Registration Statement *(cont.)*

- Determination of which individual companies would be required to include separate audited financial statements in the Registration Statement based on significance tests
 - Rule 3-09(a) of REG S-X – determines which historical audited financial statements of equity investee of the predecessor are included in the Registration Statement
 - Rule 4-08(g) of REG S-X – determines whether summarized financial information of the equity interest contributed to the Yieldco will be included in the combined historical financial statement footnotes
- Preparation of unaudited Pro Forma financial statements of the Yieldco entity (preceding year and latest interim period in current year)
- Preparation of financial statements of the newly formed successor (audit opening balance sheet)

Accounting & Reporting Hot Topics / Considerations

- Predecessor Cash Flow Statements
 - Cash vs. Non-cash
 - Equity vs Due to/from
- Segment Disclosures
 - Requires careful consideration

Accounting & Reporting Hot Topics / Considerations *(cont.)*

- Future Dropdowns
 - Treated as transactions among entities under common control
 - Use historical cost and recast all periods presented
 - Considerations around EPS (new EITF item)

JOBS Act

- “Emerging growth companies” are exempt from certain rules until the earliest of:
 - 5 years after the IPO
 - Becomes a "large accelerated filer", i.e., an issuer with in excess of \$700mm in public float
 - Has issued more than \$1.0 billion in non-convertible debt in the previous three years, or
 - Achieves \$1.0 billion in revenue

JOB Act (cont.)

- Key Exemptions include:
 - Will be permitted to include only 2 years of audited financial statements (and 2 years of MD&A) in its IPO registration statement, and future filings would not need to go back any earlier
 - Will not be required to provide an auditor attestation of management's internal controls for financial reporting created under Sarbanes Oxley
 - Will be exempt from certain accounting requirements, including the audit firm rotation and the supplemental information by audit firms requirements
 - IPO filings with the SEC by emerging growth companies can be made confidentially
 - Executive compensation disclosures will be less burdensome

MD&A and Non-GAAP Disclosures

- Distributable Cash Flow
 - Generally defined in the Partnership Agreement
 - Non-GAAP term
 - Varies across the industry
- Selected Financial Data

Internal Controls

- SEC Filing Requirements & Certification Process
- Compliance with Sarbanes-Oxley Sections 302, 404, 906
- New Levels of Precision; Continuous Risk Assessment
 - New control owners/sponsors
 - Internal audit function and/or control organization
 - Transition services agreements
 - Cultural changes
- Significant Deficiencies and Material Weaknesses
 - Staffing levels and resources
 - Maturity of processes and systems
 - Documentation and evidence

Other M&A Accounting Considerations

- Goodwill in the acquisition of a wind or solar plant
- Intangible Asset (e.g. PPAs) valuation considerations
- Cash Flow classifications considerations
- Push Down Accounting
- Transactions under common control
- Asset Acquisition or business combination



Questions?



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