

2015 Outlook on Power and Utilities My Take: By John McCue



As the future of the power and utilities industry comes into focus, 2015 is the year for companies to chart the course to growth and returns.

For the past couple of years, power and utilities industry discussions have focused on pending industry transformation due to pressures ranging from rising capital expenditures to low load growth and competition from new market entrants. What is your perspective on how companies can best navigate this industry transformation?

John McCue: First, I would say the industry transformation is no longer “pending”; it’s underway. And the good news is that opportunities for the future are starting to come into focus. Many of the moving pieces around fuel prices, renewables, customer interaction, managing distributed generation, electricity storage, demand response, and energy efficiency are beginning to fall into place — and we now see utilities taking concrete, financially sound steps to incorporate these elements directly into their business models to seize opportunities for growth, as opposed to ceding this playing field to new entrants.

While a few forward-looking utilities are well down this path, until recently the focus of the majority has been largely on defensive strategies including strengthening company balance sheets through cost reduction and leveraging traditional merger and acquisition synergies, while monitoring the playing field and assessing the risks of deploying new technologies and business models. The regulated piece of the business provides a very solid foundation to defend and build on; however, now is the time to both augment and complement that solid foundation with new and emerging technologies and business models.

You mentioned companies that have taken concrete steps and demonstrated solid results from deploying new technologies or business models. Can you provide some examples?

John McCue: Sure, we’ve seen evidence that renewable energy, deregulated customer services, and energy efficiency are all entering the maturity phase and providing solid financial results for companies.

Looking at renewable energy, wind and solar power have been around for decades. But as we heard from ACORE President and Chief Executive Officer Michael Brower at the Deloitte 2014 Alternative Energy Seminar, financiers now see renewables as an asset class understood by all, and utilities are commonly using them to hedge fossil fuel risk and provide scalable, low-cost, and distributed power. About 27% of new US electricity capacity added since 2007 came from wind power, now ranked among the least expensive sources of new utility-scale generation. In the case of solar power, major banks are vying to finance projects and portfolios, especially as the volume of distributed solar installations grows. The largest US solar installer, SolarCity Corp., has been roughly doubling annual installation volumes since 2010 and expects to install more than a gigawatt in 2015. Factors fueling high growth include solar system cost declines of 12%-15% per year; customer leasing options; and innovative industry financing vehicles, such as yieldcos and securitization.

The retail energy marketplace is also maturing. For example, Houston-based Direct Energy, acquired by UK-based Centrica plc in 2000 for about \$600 million, has grown into the largest competitive retail electricity, natural gas, and energy services provider in the United States, with 2013 revenue of \$11.4 billion, operating profit of \$436 million, and approximately six million customer accounts across North America. The company focuses on providing residential and business customers with not just a competitive energy plan, but also with insight into their energy consumption and the tools to control it. Direct Energy has recently partnered with Google Inc., SolarCity Corp., and Samsung Electronics Company, Ltd. to provide innovative products such as the Nest learning thermostat, solar panels with battery backup, and smart phone-controlled lighting.

Energy efficiency is another maturing field that has gained increased access to capital – and Opower is a prime case in point. Built around the concept of combining data analytics with behavioral science, Opower’s platform helps utilities deploy energy efficiency and demand response programs to customers, while strengthening their brands. Since 2007, Opower has partnered with more than 90 utilities and reached over 32 million electricity customers globally — a record that helped raise \$116 million from investors in its April 2014 IPO.

What is the next big step in the power and utility industry transformation?

John McCue: The evolution of the regulatory construct that we’re starting to see in New York and other states will likely bring about profound change and could potentially better enable companies to chart new paths to profitability and success as “utilities of the future.” States like Hawaii and California are on the front edge of industry disruption due

to factors like high electricity prices, abundant renewable resources, and new market entrants. But the Northeast, as indicated in Deloitte’s “**math series**,” is not far behind. New York’s “Reforming the Energy Vision” plan to overhaul its utility regulatory system is the most comprehensive response yet. The plan brings utilities, regulators, government agencies, financiers, and innovators together to achieve system-wide efficiency, reliability, resiliency, fuel diversity, affordability, carbon reduction, and most importantly, increased customer choice and value. Other states, like Massachusetts, Georgia, North Carolina, and Minnesota, are experimenting with their own regulatory changes and more are likely to jump onboard.

What do you think power and utility companies should be mindful of as they navigate this industry transformation?

John McCue: As we have discussed in **recent Deloitte reports**, every company must “do its own math.” The business and regulatory models mentioned here are quite progressive and may not be appropriate for all companies at this time. The course each company charts will be different, depending on factors like geography, customer demographics, resources, and capabilities. Each company must assess its own situation and options. But for every company, now is the time to plot the path to growth and returns in the new industry environment.



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