

ENERGY & UTILITIES

JULY 2012

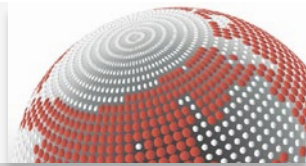
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Over the last 12-18 months, what major trends have you witnessed in the energy and utilities sector in Saudi Arabia? What risks and challenges does the industry face?

The Kingdom of Saudi Arabia continues to actively review the country's energy mix, especially given the increasing domestic consumption of Saudi oil to meet the country's soaring demand for electricity. Indeed, the major trend in Saudi Arabia over the past couple of years has been to develop additional installed capacity. For example, the Kingdom is aiming to get more than a third of its peak-load power supply, or about 41 GW, from the sun within two decades, at an estimated cost of well over \$100bn. Saudi Arabia is also looking at a host of other renewable energy projects including wind, geothermal and waste-to-fuel plants. The Kingdom has also been expanding its natural gas capacity, and plans to build 16 nuclear reactors by 2030. Investment into renewable energy has been slow due to the high cost of the renewable technology, market distortions favouring fossil fuels, a lack of skill and experience in the field, and misperceptions concerning new technologies.

Have you seen an increase in restructuring initiatives undertaken by energy and utilities companies? If so, what are the underlying drivers?

Saudi Arabia has plans to liberalise the electricity market. The move is designed to lead to a more competitive wholesale electricity market in the Kingdom by having private companies competing to sell power in all regions of the country. The motivation behind this plan is the desire to move from an industry that is primarily state owned to one that is based on a competitive free market. In addition, Saudi Arabia is the fastest growing electricity consumer in the Middle East. Electricity consumption in Saudi Arabia has increased sharply over the last decade due to the country's rapid economic development. Energy and utility companies have undertaken many restructuring initiatives during the last couple of years. During 2010, Saudi Aramco was working on the restructuring of some of its industrial projects worth about US\$30bn. Diversification of the energy mix and climate change will likely be the most important drivers for the next decade.

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How would you describe M&A activity in the sector? What factors are spurring deals?

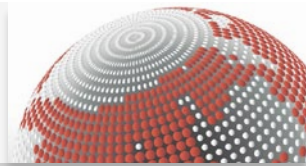
In the Middle East many companies are changing their corporate strategies from going it alone to creating relationships and alliances with other companies. For example, in July 2011, Qatar First Investment Bank announced the acquisition of a US\$16m stake in Kuwait Energy Company, a leading, independent, Middle Eastern oil and gas exploration and production company. In November 2011, Kuwait Energy announced its plan to launch an initial public offering to enable it to pursue its expansion plans to develop recent discoveries and explore additional energy sources in the region, especially in Egypt. In March 2012, Qatar Electricity and Water announced that it had completed the acquisition of 38.891 percent of the Islamic Development Bank Infrastructure Fund's shares in AES Oasis Ltd which owns a 60 percent stake in AES Jordan. The main factor driving these deals is a desire to expand operations, regionally and internationally, in order to stabilise the development of the utility business, enhance financial strength, and to increase market share.

How is the continued rise of emerging markets, especially the BRIC countries, changing the playing field of the global energy industry?

One of the most telling shifts is the fact that China now buys more Saudi crude than the US. In addition to the economic reality created by China being Saudi Arabia's top client, there are a number of geopolitical shifts which accompany this reality. In the near term the global energy industry will be influenced significantly by a shift away from OPEC to the emerging economies led by the BRICs. The increasing non-OPEC supply of crude should lead to an increase in production capacity, greater openness, and a more friendly investment climate. While production has increased significantly in some of the BRIC countries, Saudi Arabian production continues to play a leading role in stabilising the global oil market. While non-Middle East countries pump at full speed, Middle East producing members of OPEC stick to a quota and produce under their capacity. This means that non-OPEC oil will likely run out faster than OPEC's. Exxon Mobil Corporation has estimated that non-OPEC production will peak within a decade.

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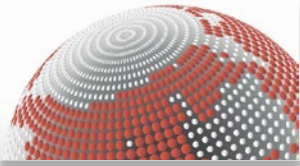


How do you expect the energy mix (nuclear, coal, shale gas, etc.) to evolve in Saudi Arabia over the coming years?

The energy mix in Saudi Arabia will continue to shift in the long term. Though, in the short to medium term oil will continue to be the dominant fuel. As noted, the Kingdom has launched ambitious solar and nuclear programs, though it is unclear how quickly those programs will be implemented. Saudi Arabia will be able to increase production of natural gas in the near term with the world's fourth largest known gas reserves. Saudi Arabia plans to build 16 nuclear power reactors by 2030. The Kingdom plans to cover 20 percent of its electricity needs using nuclear energy to offset the demand for power which is expected to grow by 7 percent to 8 percent each year during the next 10 years. In June 2011, the Saudi government signed a nuclear energy cooperation deal with nuclear desalination specialist Argentina and, in February 2011, a cooperation agreement on developing nuclear energy for peaceful purposes was signed with France. A nuclear cooperation agreement was also signed earlier this year with China. Shale gas has been largely overlooked because of massive oil and gas deposits. However, Saudi Aramco has announced a plan to develop its shale gas reserves.

Have any notable energy policies and regulations been introduced in Saudi Arabia over the last year or so?

Saudi Arabia is planning on a multibillion dollar investment to create a solar industry that generates a third of the nation's electricity by 2032. King Abdullah City for Atomic and Renewable Energy (KACARE) was established in 2010 to oversee the nation's renewable energy strategy. KACARE recently announced that it is targeting 54.1GW of renewable energy by 2030, around 41GW of which will be solar. The plans will start with a procurement program of about 1100MW of photovoltaic solar, 900MW of concentrated solar power, 650MW of wind power and 200MW from other sources with tendering starting in 2013. The government of Saudi Arabia is targeting 25,000 MW from solar thermal plants, which use mirrors to focus the sun's rays on heating fluids that turn a power turbine. Another 16,000 MW would come from photovoltaic panels. Saudi Arabia is taking an active role in enacting policies



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towards building a lower-carbon economy. KACARE serves as a centre for renewable research and for co-coordinating national and international energy policy.

In what ways are energy and utilities companies responding to current environmental issues and challenges?

Saudi energy and utility companies have been proactive in the development of management systems, operational practices and engineering technology geared to minimising negative environmental impacts. Various novel technologies have been applied to the disposal of drilling waste, as well as water and air emissions. Companies have committed to invest billions of dollars in alternative energy, as well as infrastructure, water, sewage and waste treatment. While Saudi law provides the framework for ancillary regulations requiring environmental assessments, plans for waste disposal and control of emissions and discharge moving towards sustainability is a work in progress.

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