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Texas power market changes could lead to consolidation among retail electricity providers, industry sources say

- Sellers could include Bounce Energy, First Choice and Amigo Energy
- Buyers could include StarTex, Ambit, Champion and Just Energy

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Texas' new wholesale power market, known as nodal, could cause disruptive change, distress and M&A among retail electricity providers (REPs), said industry executives, an industry consultant and an M&A advisor. One executive agreed consolidation was likely but that nodal would not be the cause.

Nodal, which affects how REPs purchase energy from the grid and went live last month, impacts the areas under Electric Reliability Council of Texas (ERCOT), which operates the grid servicing 85% of the electricity load in Texas. The new system will lead to increased variability and price swings in the wholesale market, as well as new charges for REPs that do not adequately plan their electricity purchases.

"There's going to be some REPs having trouble with nodal," said Bob Zlotnik, CEO of Houston-based **StarTex Power**, an REP with sales of USD 317m in 2009. REPs that have not hedged properly will either pass price increases on to customers, where state regulations allow, or be forced to absorb the costs, he said. Several other executives polled by this news service echoed his sentiment, but Scott Fordham, CEO of Houston-based **Champion Energy Services**, described nodal as "a big nothing" and compared it to the Y2K scare. He did agree that consolidation was coming, however, describing the REP market as being overcrowded.

Buyers are "hoping for some distressed opportunities," said Rob Potosky, head of M&A at **AEG Affiliated Energy Group**. As the summer months approach and energy demand spikes, Potosky believes the possibility of problems for REPs should also increase. In 2008, natural gas prices spiked and approximately 30 Texas REPs, which had not properly hedged, went out of business when they were forced to absorb the extra cost of the energy, noted an industry consultant. There are currently 86 REPs operating within Texas, according to Texas' Public Utility Commission. **TXU Retail**, **NRG** and **Direct Energy** are the three largest REPs, and both NRG and Direct have grown through acquisitions.
Houston-based **Bounce Energy** could be interested in selling, said an industry executive. Bounce's CEO Robbie Wright acknowledged his company could be an attractive target but said it was not currently for sale.

The industry executive also suggested niche players such as **Amigo Energy** and Irving-based **First Choice**, which have developed a focus on marketing to Hispanic consumers, could be targets. He called out Champion Energy as a company that might be forced to sell because of rumored internal difficulties.
Champion's Fordham refuted claims the company was in distress. "We're the best capitalized REP in the business," he said, adding that Champion was "going to be an

acquiror, not the one being acquired." The industry consultant had no direct knowledge of problems at Champion but thought the company was "much better off" since receiving an equity infusion in December from **EDF Trading**, a division of France-based **EDF Group**, along with signing a wholesale supply agreement.

The consultant was aware of other REPs that have inked deals similar to Champion or hoped to do so because creditworthiness is more important in nodal than in the previous zonal system. He identified **Shell Trading**, **Macquarie Bank**, **Bank of America** and **Morgan Stanley** as financial players that were being approached by REPs seeking to obtain better credit backing. For some REPs, the changeover to nodal is an impetus to sell their business rather than try to adapt, said the consultant. Those companies could be targets for mid-sized REPs that have the financial wherewithal and seek to expand, such as StarTex Power, which this news service previously reported was interested in buying up the books of business of smaller players.

NRG acquired **Reliant Energy**'s retail business in 2009 for USD 287.5m and Austin-based **Green Mountain Energy**, which sold electricity generated from renewable energy, for USD 350m in late 2010. The Green Mountain deal was relatively unique because its brand could not be "easily duplicated," Potosky said. Many REPs will have difficulty demonstrating they are worth more than their book of business, with portfolios of creditworthy customers on fixed-priced contracts commanding the highest valuations. In some cases, however, troubled companies must pay other REPs to assume their book of business, Potosky noted.

Ambit Energy, a Dallas-based outfit with revenue of USD 325m, could be a potential buyer of other REPs with multi-level marketing distribution channels, said the first industry executive. Companies that fit that description include Dallas-based **Stream Energy** and Houston-based **Affordable Power**. **Just Energy**, a Canada-based REP with operations in Texas, has been an active acquirer. Last April, the company paid USD 304m for **Hudson Energy Services**, a New York-based REP also with operations in Texas.

by Mark Druskoff in Houston, Texas