

Looking for the light

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Radiation from Japan's failed nuclear plant has been recorded as far afield as Scotland, China and the U.S. The doses are tiny, a testament to the sensitivity of measuring equipment rather than the threat to global health -- unless the health in question is that of the nuclear industry itself.

"While the 1986 Chernobyl accident, at least to date, had a significantly greater environmental impact, we would argue that Fukushima raises even larger credibility issues for the nuclear industry than previous accidents," **UBS** analysts noted April 4. "At Fukushima, four reactors have been out of control for weeks -- casting doubt on whether even an advanced economy can master nuclear safety."

In Europe and the U.S. and to a lesser extent China, Japan's disaster has drained political support for nuclear expansion and sent the value of sector assets tumbling. The ongoing crisis at the Fukushima Daiichi plant will clearly reshape the global energy sector. What remains to be seen is how deep the changes will go, how extensive safety upgrades will be -- and which companies will emerge as winners and losers in the new environment.

Tokyo Electric Power Co., the operator of the stricken plants, has been crippled by the event. Shares in Tepco have plunged almost 80% since the crisis unfolded on March 11. The company's debt rating has been slashed as reports of negligence, and thus potential culpability, have emerged.

Liabilities of as much as ¥11 trillion (\$133 billion), temporary nationalization and possible bankruptcy await Japan's biggest utility if the disaster isn't contained within two years, says **Bank of America Merrill Lynch's** Tokyo-based analyst Yusuke Ueda.

"There is lots of discussion about nationalization, but I will do my best to ensure Tepco remains a private company," Tepco chairman Tsunehisa Katsumata told reporters at the end of March.

Shares in nuclear utilities across the globe have dipped in the wake of the Fukushima crisis. They may never recover, according to a UBS report, which notes that "if liability [for future accidents] will be wholly or partly with the operators, we think discount rates will likely need to be higher."

Dealmaking has not escaped either. On March 22, **Mantra Resources Ltd.**, an Australian operator of Tanzanian uranium assets, accepted a 12% reduction, to A\$1.02 billion (\$1.06 billion), on its agreed sale to Russia's state-owned **Rosatom Nuclear Energy State Corp.** Rosatom had threatened to pull out of the deal, claiming that the incident at Fukushima had materially changed the market for uranium.

Worse could still be in store for the nuclear sector as politicians weigh growing public concern about both existing plants and the construction of new facilities.

The political backlash against nuclear energy kicked off in Germany within days of the disaster. The German government of Angela Merkel, mindful of upcoming state elections and long-standing voter opposition to nuclear energy, suspended a decision to extend the life of 17 plants and ordered seven of them, built before 1980, to be closed for safety checks.

The move failed to save Merkel's coalition government from its own political upheaval. On March 27, voters in the southern state of Baden-Württemberg flocked to the Green Party, tripling its vote and handing it a role as a junior partner in a state coalition with the Social Democrat Party. Merkel's Christian Democratic Union found itself out of power in the state for the first time in 58 years.

Germany "is clearly a country where the future of the nuclear industry is uncertain," says Damien Sauer, a partner at M&A adviser **Greentech Capital Advisors Securities LLC** and former head of M&A at **Areva SA**, a French maker of nuclear reactors. "But I don't think you will see that in many other countries."

For the most part, the fear in the nuclear industry is not of government-mandated closures, but the likelihood of new and, as some see it, unnecessary safety requirements. These will inevitably add costs to nuclear utilities' operations, potentially making existing plants unprofitable and damaging the investment case for new operations.

Britain's Deputy Prime Minister Nick Clegg on March 29 seemed to pre-empt his country's review of safety at 19 existing nuclear plants, suggesting that it would make facilities more expensive and could render nuclear energy in Britain uncompetitive.

Clegg, whose Liberal Democrats are long-standing critics of nuclear energy, said the government would not underwrite the ongoing operation of the plants or subsidize plans to build a further 10 new reactors.

"In Europe, the U.K. will be the trendsetter, and everyone will watch what happens there," says Sauer.

None will watch the U.K.'s reaction more closely than France's two biggest utilities. **Electricité de France SA**, the operator of most of France's nuclear energy assets, struck a £12.5 billion (\$20 billion) deal for British Energy Group plc, operator of most of the U.K.'s nuclear energy assets, in September 2008.

The deal was based on an assumption that Paris-based EdF would be allowed to extend the life of existing reactors and build new plants. **GDF Suez SA**, EdF's crosstown rival, also has good reason to be worried.

It paid a little under £5 billion in cash and assets in August 2010 for Britain's International Power plc, a deal that was meant to give the Paris-based firm a platform to extend its nuclear interests in the U.K., U.S. and the Middle East.

A fundamental rewriting of nuclear safety regulations and the crimping of new build programs may come to mean that both deals were done near a peak in the nuclear market. The safety reviews, including the one announced last month by the U.S.'s Nuclear Regulatory Commission, may yet benefit some in the nuclear energy sector.

French and U.S. reactor producers, such as the world's biggest maker of nuclear plants, Paris-based Areva, and Fairfield, Conn.-based **General Electric Co.**, might yet welcome an upgrading of safety regulations.

Both companies face increasing pressure in nuclear plant tenders from rivals who undercut them on price. In December 2009 they missed out on a \$20 billion contract to build four nuclear plants in the United Arab Emirates, beaten to the contract by a South Korean syndicate.

Stricter safety standards would play to the strengths of Areva's admittedly expensive European Pressurized Reactor, or EPR.

Seen in that light, French President Nicolas Sarkozy's April 2 call for a reform of global nuclear standards may not be as altruistic as it first seems.

Ironically, a German decision to completely abandon nuclear energy could benefit EDF, which would be the obvious candidate to supply the shortfall in German power needs from its own stable of nuclear power plants.

If some nuclear sector companies harbor hopes of scraping meager benefit out of a generally dire situation, it is clear that other sectors of the energy industry have nothing to lose from a nuclear energy backlash.

The most evident short- to medium-term winner will be gas providers. As Thierry Bros, an analyst at **Société Générale**, recently noted, political opposition to both nuclear and carbon-producing coal may mean gas becomes the "fuel of no choice in [Organisation for Economic Co-operation and Development] countries."

That would benefit U.S. shale gas asset owners, many of which have been pressed to sell assets in recent months to recoup cash as long-term low gas prices affect their balance sheets. Higher gas prices would also speed the growth of Europe's fledgling shale gas industry, potentially shortening the span of Russia's current stranglehold on much of Europe's gas market.

Few believe the nuclear energy industry is finished, but the reaction to the Fukushima crisis could accelerate a shift in its center of gravity. While new plant development in the U.S. and Europe is slowed, China is already in the process of building 27 new reactors. Some 90 others are in early planning stages or have been licensed.

"China will have more buying power because it will be the only player in the game. At the same time, potential shortages in expertise and fuel that might have slowed its [nuclear energy] program are likely to disappear," says Jack Plunkett, CEO of Houston-based **Plunkett Research Ltd.**

As Plunkett sees it, it is not just the size of Beijing's program that will establish China as the center of nuclear excellence, but its willingness to adopt new technologies. China is leading the world in the development of a new generation of pebble-bed reactor -- where fuel is stacked in tennis ball-sized spheres of graphite that lower the risk of meltdown -- and in smaller modular reactors, which can be built off-site and then deposited where needed. "The playing field has tilted in China's favor in a lasting way," predicts Plunkett.

China's likely primacy in the field of nuclear energy will matter only if the West eventually embraces a nuclear future. As long as the crisis in Fukushima remains unresolved, that remains a distant prospect.