Friday, July 24, 2009 2:11 PM ET Exclusive

Exelon-NRG: Another chapter in failed power sector consolidation

By Jay Hodgkins

With the failure of Exelon Corp.'s hostile takeover bid for NRG Energy Inc. on July 21, major consolidation in the power sector failed once again.

NRG-Exelon now joins Exelon-Public Service Enterprise Group Inc., NRG-Calpine Corp., Constellation Energy Group Inc.-FPL Group Inc., Constellation-MidAmerican Energy Holdings Co., NRG-Mirant Corp. and many other failed deals in the ranks of M&A near misses that will be told around the tables of industry old-timers someday.

With the death of the proposed deal, the power sector now sits without a single pending major whole company deal in the works, despite company executives and industry observers sounding a nearly unanimous chorus that the sector needs to consolidate to meet major oncoming challenges, including replacing aging infrastructure and adjusting to climate change regulations. To hear many CEOs talk, one would think power companies across the nation are eager to marry their operations.

The question has been posed more than once to NRG President and CEO David Crane, who is as vocal a proponent of industry consolidation as any CEO: If NRG could benefit from consolidation, why oppose Exelon?

Crane and NRG's reliable response to the question was that NRG looks forward to any solid opportunity to consolidate, but that Exelon's offer did not present enough value to NRG shareholders.

After the July 21 annual NRG shareholder meeting, Crane addressed the bigger issue of why industry consolidation is so very difficult despite consensus that it must happen. While many times regulatory hurdles eventually crush big M&A deals, Crane acknowledged that major differences in each party's perspective on value also frequently prevents the consummation of what could otherwise be good deals, such as was the case with Exelon-NRG.

"It's hard. It's hard. It has to happen, and we are big believers that deals have to get done in a cooperative fashion," Crane said. "I think [industry consolidation] will get done and I think a lot of it will have to do with the attitude of the hybrid utilities."

By hybrid utilities, Crane said he meant the handful of large U.S. diversified utilities with significant regulated and unregulated operations, like Exelon, PPL Corp., Entergy Corp. and a few others. Those utilities, Crane said, will drive consolidation — or perhaps even fragmentation, as in the case of Entergy's proposed spinoff of its merchant nuclear assets — in the industry.

Despite most industry observers seeing pure independent power producers like NRG as among those with the greatest potential to benefit from consolidation, Crane said he could not say why NRG or other true IPPs have not really done so. It has not been for lack of chances as NRG has been on one side or the other of the eat-or-be-eaten equation three times in the past few years, with each deal failing to come to fruition.

As the largest power company in the United States — but still a relative dwarf compared to the world's largest power companies — Exelon has made itself one of the primary movers attempting to bring consolidation to the industry, but has not found success in recent years.

Exelon Executive Vice President William Von Hoene expressed his company's frustration after the NRG shareholder meeting after being asked about Exelon's failed M&A attempts.

"[Consolidation] is very difficult to do and that's interesting given a fair amount of people believe consolidation is needed," Von Hoene said. "We tried to convey that message to NRG shareholders."

With their nine-month ordeal freshly over, Exelon and NRG would both have the market believe they will be on the M&A sidelines for a while, even though both are among the most active and opportunistic U.S. power companies in the M&A space.

Von Hoene said Exelon has no other M&A plans and that "nothing is on the table," noting that Exelon will focus on its standalone opportunities.

Exelon Chairman and CEO John Rowe backed up that statement July 24 during the company's quarterly earnings call when he said Exelon sees no other M&A opportunities it can pursue as NRG was a unique acquisition opportunity better than any other potential option available.

"Our view is simple. We have no near-term acquisition plans," Rowe said. He hammered the point home by saying Exelon does not have some secret M&A

backup plan to pursue after the failed effort to acquire NRG, as some have speculated.

At the present time, Exelon believes investing in its own assets and opportunities is the best way for it to spend its money, Rowe said, like a potentially major new venture into new transmission projects of which the Exelon chief would only give hints.

Sanford C. Bernstein & Co. LLC analyst Hugh Wynne told SNL Energy on July 21 that sensible acquisition opportunities for Exelon are scarce, anyway.

Wynne said the only potential acquisitions that would benefit Exelon's investment profile would be to purchase the fleet of merchant nuclear plants Entergy is looking to spin off or to purchase Constellation's nuclear fleet, which is not an option due to the company's pending nuclear joint venture with EDF Group

The analyst said Exelon could turn around and try to acquire another IPP like Mirant or Dynegy Inc., but noted such a move would perpetuate uncertainty around Exelon's stock and prevent a significant stock price recovery.

Crane said NRG, too, will focus on executing on its full plate of internal growth opportunities while aggressively trying to improve the performance of NRG stock for a shareholder base that just gave them a major vote of confidence.

In fact, despite "10 or 15" total major European and U.S. utilities and private buyers emerging as potential buyers of NRG during the Exelon process, Crane said NRG will not go back to any of them to explore the possibility of an amicable deal.