



Role of Commercial Department

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The joy of Accounting.....



After his first day, Lester, the new accountant for Acme Solar, Wind & Biomass Energy, Corp., realized he had become a green bean counter.

- Role of Commercial department:
 - Support the PM in commercial negotiations
 - Financial evaluation and analysis; owner of financial appraisal model
 - Screening of project activities; facilitate robust decision making
 - Provide timely, relevant and accurate information to manage the business and provide strategic direction.
 - Preparation and presentation of Business Case
 - Ensure commercial reality is reflected in legal contracts
 - Ensure the interests of BGE are protected at all times
 - Ensure all project risks are managed, monitored and mitigated

Financial Appraisal Techniques



- BGE uses a number of financial appraisal techniques to assess development opportunities:
- **Return on Equity (ROE):**
 - Primary tool used by BGE in appraising projects
 - Calculates % return based on capital invested
 - Detailed financial model prepared for each project, forecasting development cost and annual cashflows during operational life (revenue and operating cost)
 - Takes account of time value of money
 - Cashflows discounted using a discount rate which takes account of project risks (volatility of earnings, regulatory support)
 - The higher the risks, the higher the return required
 - ROE calculated and compared to “hurdle rate” set by shareholder/Management Team
 - Range of hurdle rates for assessing different projects
 - Go / No-Go decision
 - e.g. Say hurdle rate for a particular category of projects is 10%, then:

	Project A	Project B	Project C
	9%	11%	16%
Invest in Project?	x	✓	✓

Financial Appraisal Techniques (cont'd)

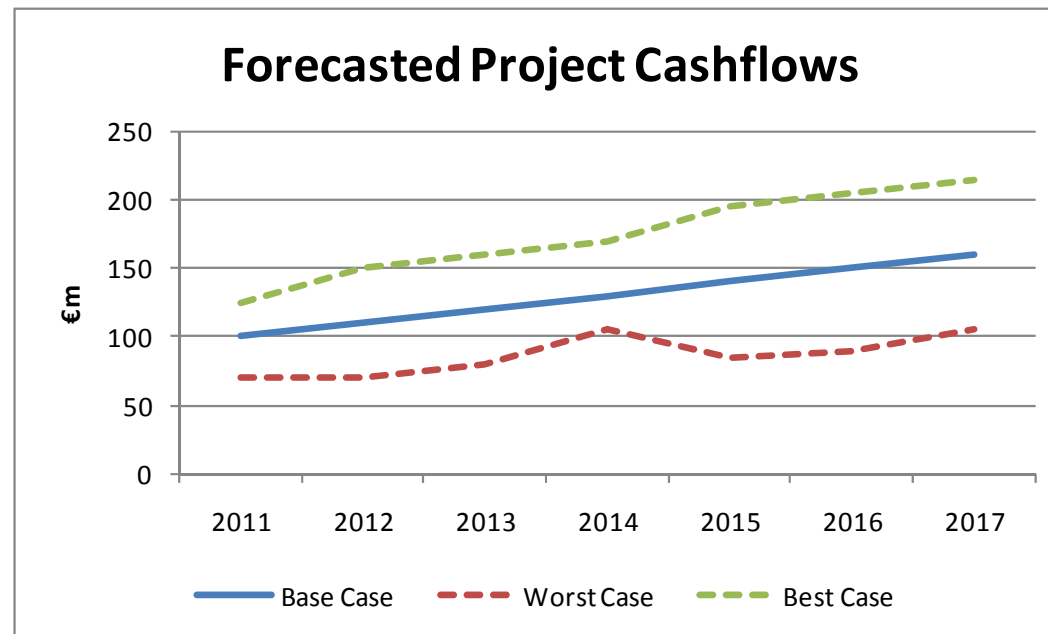


- **Payback period:**
 - Period of time required for the return on an investment to "repay" the sum of the original investment
 - Expressed in years
- **Financial Model:**
 - Assumptions constantly refined throughout development cycle
 - Reflect commercial reality of contracts
 - Peer Review
 - Update for tendered values
 - Include contingency (unforeseen activity, market movements; decreases as project moves towards financial close and level of certainty increases)
 - Sense check: benchmark to expected result and/or industry metrics

- Final sign-off stage for capital development budget (post tender, prior to contract signing)
- The purpose of the Business Case:
 - Justifies investment and seeks approval for development budget
 - Sets out the key financial assumptions used in calculating the ROE
 - Provides a detailed description of the current status and outstanding issues in relation to each component of the project (planning permission status, grid connection arrangement, landowner agreements etc)
 - Sets out the construction methodology and project programme
 - Sets out key project risks and mitigants for same
 - Key sensitivities and stress testing of ROE
 - Sets out how the project will be managed once operational
 - Benchmark against other similar projects (or rank against competing investments)
- Approval Stages:
 - Divisional Management
 - Executive Team
 - Board of BGE
 - Dept of Communications, Energy & Natural Resources (as shareholder) and Dept of Finance

Business Case (cont'd)

- Stress testing of business case: if certain events occur, what impact will these have on the forecasted ROE?
- What about factors that cannot be quantified?



- Safe operations are a key component of the way BGE operates. BGE encounters risks in all facets of its operations on a day-to-day and these can be as diverse as:
 - Transporting gas – high pressure pipelines, Public Reported Escapes (gas leaks), risk of failure of the Interconnector pipeline
 - Sales Personnel – trips, slips & falls of employees calling to over 1,000 homes per week
 - Construction risk of developing windfarms – invariably windfarms are located in remote, forested locations with challenging terrain and ground conditions
- Risk Management is the process by which risks are identified, assessed, managed and controlled.
 - What can go wrong?
 - What is the likelihood of the event occurring?
 - How bad will it get (Severity of Impact/Consequences)?
 - What (and when) are we going to do about it? (Controls)
 - What are the likely indicators that a risk may materialise
 - What are the

Risk Management – Development Cycle

- Key is to identify and understand the implications of a risk occurring
- Never ignore a potential risk item
- Track all risk items and seek to minimise the potential impact of occurrence
- Where possible have contingency plan B
- Where not possible – quantify the risk and decided if acceptable before proceeding



Risk (cont'd)



- **Categories of Risk:**

- Strategic (integral in the Balanced Scorecard & Corporate Planning Processes)
- Financial (including controls, balance sheet, tax, pricing, treasury, currency etc.)
- Operational (including Health & Safety & Environmental)
- Compliance (including Legal & Regulatory)
- Reputational
- Technology / IT

- **Sources of Risk:**

- Economic circumstances
- Competitive behaviour
- Natural events
- Political/regulatory circumstances
- Commercial and legal relationships
- Technology & technical issues
- Management & individual activities/Human Behaviour/Staff Skills & Competencies

Managing Risk (cont'd)

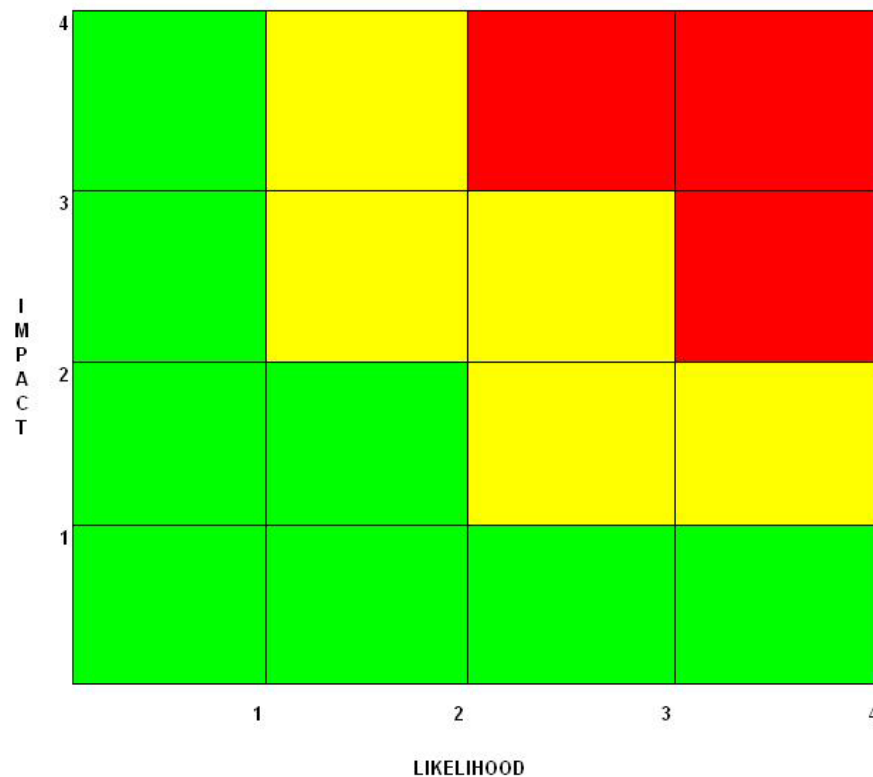


- BGE mitigate & manage risks using the following tools:
 - Risk Matrices: Project level, Divisional level, Group level
 - Monthly Risk Management Committee
 - Risk Audits
 - Heat Maps
 - Risk Radars
 - Feedback loop: lessons learned applied to new/existing projects
- In the context of risk, the role of the Commercial Department is to:
 - Ensure BGE's interests are protected through appropriate contractual arrangements and risk apportionment
 - De-risk the project (e.g. Long term maintenance agreements)

Risk Matrix



RISK HEAT MAP



Likelihood:

4: Very likely, will occur in most circumstances (next 6 months)

3: Likely, may occur (6-12 months)

2: May occur at some point (1-3 years)

1: Rare, never happen, may occur in exceptional circumstances (3-5 years)

Impact:

- Hugely Significant
- Very Significant
- Significant but containable
- Minor Impact

In assessing the Impact of a potential risk BGE considers the financial, reputational and business continuity impacts

Getting the right balance

Continuous challenge to strike a balance in our approach to risk management

