

DONG ENERGY 2010-2012

“An analysis and evaluation of the business and financial performance of Dong Energy 2010-2012: the greener future.”

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PART 1

(Introduction

The report is a study and analysis of the business and financial performance of Dong Energy over a three years period 2010-2012. I will compare financial and non-financial elements influencing the business and financial performance with industry sector for which an appropriate competitor Fortum has been selected.

Reasons For Selection

I chose to write about Dong Energy, because I want to put into practice the analytical skills I have learnt in my ACCA studies. I believe that by completing this task I will learn the practical side of financial and business analysis and how the use of selected analytical methods can give greater understanding and of commercial and financial performance. I also aim to deepen and fix my understanding of accountancy concepts already gained in ACCA studies up to this point. I think that topic has the strongest connection to the most significant parts of accountancy knowledge and therefore I decided to select that area of study.

I selected DONG Energy as power and energy is taking more and more space in political and social debate, showing how society is looking towards growth, ecology and economy. In this time of post-financial and debt crisis the world is still struggling with stimulating economy and in the face of growing global warming fear, energy production and consumption becomes even more delicate subject.

My personal interest will be to find out to what extent transition to greener energy has had an impact on financial performance of one company operating in Europe. I was always interested in power and energy sector in which DONG operates and I would like to identify the key factors behind its continued importance in the face of global economic difficulties.

I have chosen FORTUM plc as the comparator company because it operates in the same sector, has similar revenue and covers similar (but not the same) geographic region – that has got huge implications for energy companies, as low temperatures affects significantly yearly results, so comparing Dong to other company operating in south of Europe would miss the purpose. Both companies are looking towards reducing its CO2 emissions and investments into new technology, which is again another level that brings them alike and allows comparison. FORTUM will provide me with a perfect benchmark against which I will be able to assess DONG's performance.

Project Objectives

I have chosen project objectives which are realistic given my knowledge and learning of this topic. The objectives of the project are as follows:

1. To evaluate DONG's financial performance over the last 3 years.
2. To evaluate DONG's business performance over the last 3 years.
3. Evaluate financial and business influence of transition to green energy.

Further to above objectives, the research questions I will investigate and conclude on are:

1. How has DONG Energy performed compared with FORTUM?
2. To what extent has DONG been able to achieve its strategic goals?
3. How much transition to wind energy allows meeting strategic objectives of DONG Energy?

What I intend to find in my research will fall into two main categories:

- Financial decisions – thanks to analysis of selected ratios I will be able to draw the outline of financial performance. I will look into the three-year trends and attempt to draw conclusions in the context of business performance. I will also comment on how Dong Energy ratios compare to Fortum, which will place me in the position of giving more objective recommendations at the end of the RAP. Selected ratios will also allow me to draw conclusions on the influence of investment in green energy.
- Business decisions – how Dong Energy responds to current threats in the market and if it strengthens its position. I will look into the opportunities that are ahead of the company and see how the weaknesses are being tackled. I will then intend to understand if long term business decisions bring Dong energy closer to their strategic objectives and how green energy fits in meeting these targets.

Research Approach

I approached this research starting with finding and posing appropriate research questions. That allowed me to focus on the most necessary study that will address and investigate the problem. Once I was confident that the questions giving enough depth to the analysis I reviewed financial statements of Dong Energy that is the subject of this work. I also read statements of another five power & energy companies within the same sector to gain more perspective on the industry changes. Based on that stage I was able to choose suitable competitor to Dong and also allowed me to examine all factors that have significant influence on this industry. I subscribed to newsletters of Bloomberg New Energy Finance and several other web sites in order to stay up-to-date with the most recent news on the transformation of the energy market. Once I researched financial statements and studied web sites and available articles on Kaplan Library I moved on to create ratios that will be needed to analyse financial performance of studied companies. From twelve ratios I later decided to choose only six, which will reveal the performance in the most accurate context. When writing my findings part of the RAP I specifically focused on answering my three questions,

so I address precisely the objectives of the report. This study and its methods are fully subject to the research objectives and research questions.

During this Research Analysis Project I will follow the working hypothesis as my conceptual framework in order to move forward with the inquiry. Even if the statement of my expectation will fail at the end of the research, I will analyse in depth the business and financial performance of Dong Energy assuming that the company is making the right business and financial decisions in their transition from fossil based energy production to renewable energy generation. I will firstly define sector outlook to bring a context to the analysis. Next I will study financial performance looking at main financial ratios and compare them against industry (in this case Fortum is selected as appropriate comparator). Later I will use SWOT and PESTEL (Paper P3. Business Analysis, 2010), which allow me to analyse and understand business side of Dong Energy. At the end I will draw conclusions and recommendations and answer my research questions. I will finally take position towards my working hypothesis and judge if my statements failed or were right.

PART 2

Information Gathering

In order to be able to assess the financial and business performance of Dong Energy, it was necessary to gather substantial amount of data not only about the company itself, but also about the economy, politics, technology and finally about energy sector and peers that may support findings of my research. I will investigate a variety of sources from which to obtain secondary data to ensure my research is objective and unbiased. Apart from data I will gather from major and national institutes, like International Energy Agency, Eurostat, U.S. Energy Information Administration, OPEC, United Sustainable Energy Agency, World Bank I will also use the annual reports of DONG and FORTUM plc. to obtain the data I need to compare their performance over the 3 years. I will refer to my ACCA F7 and P3 study texts to research financial ratios and business models which I can use to answer my research questions. I will refer to websites such as the BBC and the Bloomberg in order to provide me with further information about DONG's performance. Information Gathering is one of the key assessment criteria for the RAP and so it is vital that I undertake extensive research to demonstrate my graduate skills needed to pass the RAP. I will also reference all sources of information used in my List of References, using the Harvard Referencing System.

I decided to gather secondary data that could in general be divided into below types:

Data relating to the sector outlook

Data relating to an organisation (ownership, history, news release, business decisions, financial data, etc.).

Data relating to the peers in the energy sector (business and financial performance over last years in particular Fortum).

Data relating to sector legal and political developments and changes.

Data relating to economic and other changes.

Porter found that many external factors affecting performance of companies. Recent years brought several political and legal proposals that changed the outlook of energy sector and most probably will become one of the milestones in the global transition into renewable energy generation.

From all gathered data I will focus on the most relevant factors that in my opinion did influence the performance of the company.

Primary Research

I do not consider primary data to be necessary for this topic as the research questions can be answered using secondary data.

Secondary Research

In order to be able to assess the financial and business performance of DONG, I gathered substantial amount of data about company, economy, politics, technology and energy sector. I undertook extensive secondary research in order to establish the academic credibility of my project and satisfy the OBU assessment criteria. To begin with, I will refer to relevant business reviews, magazines and websites to investigate DONG and FORTUM's financial performance during the 3 year period as well as overall energy market conditions. I will obtain copies of DONG and FORTUM's financial statements for the 3 years from their company websites. I will refer to my ACCA study texts as well as to financial statements for financial ratios and business models which I can use to assess business and financial performance. I will then research DONG's strategic goals using the website and financial statements. Finally, I will use DONG's financial statements, newspaper articles and relevant websites to research the financial feasibility of renewable energy.

For the purpose of this research I used only secondary data being aware of its limitations. I found secondary data appropriate and sufficient source of data for this research. Main advantages of using secondary data are:

- Secondary data is secure, quick and easy to obtain
- Wider range of data

There is also a variety of limitations to secondary information:

- Secondary data may not meet requirements and needs of the project
- Data may not be accurate
- Relevant information may be obscured
- Information about the sources of data may not be available

Use of secondary data allows drawing conclusions on 'bigger picture' and thanks to the internet access to information is easy and quick. In the same time being aware of the limitations above, I created safeguards for the purpose of this research in order to keep my findings high quality and accurate. In general, newspaper information or publications that come from unreliable sources would not be used in forming conclusions, where data of major and international institutions would be considered exact and accurate and would be

taken into consideration when forming an opinion. My main concern in using qualitative data (newspapers, online magazines, publications) was that they may simply reveal current mood, which may not be accurate in the long term and may simply be biased. This threat however can be safeguarded by the use of quantitative data (statistics, financial reports, and other research) that will clearly indicate if the trend can be verified and confirmed by numerical findings. Every time when facing problems of subjective influence, poor validity or low quality data I would test it against other, more reliable sources to validate the results – mainly in numerical data.

Limitations of Information Gathering

I am aware that some websites can be subjective, poor validity or low quality data – to overcome this difficulty I will test it against other reputable websites to validate numerical data. Online material can quickly become out of date and so I will use the most up to date sources I can find to ensure accuracy. There is a vast amount of information online and so I will focus on information relevant to my research questions. The financial statements of DONG are published in Danish krone. In order to avoid currency fluctuations distortion over the 3 year period my findings and ratio calculations will be presented in euro using average exchange rate of the last calendar year for each reporting year in order to compare the results with FORTUM.

Limitations of Analytical Tools

My first stage of the analysis project was the analysis of revenue growth, net profit margin, quick ratio, debt to equity, ROE and interest cover.

Porter's PESTEL and SWOT analysis that follow the ratios will give the study correct background to my later findings and finally allow me to make forecasts and recommendations in the last stage. For that purpose I will use two forecasting techniques: linear regression and time series analysis. The core of the research will be executed by the use of ratio analysis (profitability, growth, debt, ROE, etc.) which will be then put against the performance of the industry in order to see how Dong Energy is performing.

I came across a number of limitations and obstacles when analysing the data. Fortum's reporting currency is Euro, when Dong is reporting its financial statements in Danish Krone. To be able to compare I had to bring both companies to one currency and I chose to present it in Euro as Dong is providing part of its financial statements in that currency it was more natural step to take. There is however a limitation to that assumption - when exchange rate fluctuates, some differences may be due to changes in currency value rather than performance.

I had to make series of assumptions when comparing financial statements of both companies. They are all reasonable assumptions, like when drawing equal sign between following financial items: material and services (Fortum) and cost of sales (Dong) or employee benefits (Fortum) and staff costs (Dong). It is common problem that companies tend to give different names to its reported items, but I followed the rule of substance over form and always investigated what the reported figure is composed of to determine to which category it belongs.

I understand that ROCE is widely used to assess profitability of companies. Dong however, changed the methodology of ROCE calculation in 2011 due to transfer to IFRS. To be able to compare like with like, I decided not to use that ratio and focus on others that will allow me to investigate the firm's performance more accurately.

Dong has reported its segments giving bottom line eliminations & IFRS adjustment figure. To be able to arrive at EBIT number I had to allocate eliminations to all segments based on percentage of revenue. Again that was reasonable assumption and I had no other possibility to move on with my research.

As long as Fortum and Dong Energy are comparable at firm level, it is not possible to find equivalent across business units. Having not enough data I decided limit my comparison only at company level.

Choosing Fortum as a suitable comparator I took under consideration the size of the company (based on revenue) and geographic region in which they operate. I acknowledge it is not perfect match, knowing that Fortum operates also in Russia and Dong is not exposed to nuclear energy issues, but these companies are as close as can be in terms of firms operating within the same industry.

Finally I am aware of the limitations of the accounting and business techniques used for the purpose of this project. The main problem that will affect the conclusion of this work is that most of the green transition that took place between 2010 and 2012 will start bringing lasting effects in the long-term. I may fail to be able to prove that Dong Energy is significantly better/worst off, as some of the benefits may only be visible in the long term time frame, following recent development. For that reason I will interpret some indicators as a sign of new trend. PESTEL is likely to bring the background of this research to our attention, but for the purpose of this work will have to only consider the most important events. Many of these legal, political and financial incentives that play key role in growth of renewable energy may simply be reversed in the near future following unpredictable major event, like for example availability of new and cheaper source of energy (fusion) or another major economic crisis as a result of breaking euro currency. There are also limitations of linear regression where the assumption that the behaviour of historical data will continue into the foreseeable future. This part will only be speculative as the energy prices are subject to many unstable factors. Time series analysis makes assumption that past pattern of data such as seasonality may be used to forecast future trend. Where the main advantage is accuracy and non-linear forecast, time series analysis brings only one serious and relevant disadvantage that we will use historical data. Seasonality is unlikely to change in short term energy consumption.

Ethical Issues

There could be instances when secondary data is biased – especially in the energy market that relates so closely to economy and politics. To overcome this issue I will use a range of sources from which to gather information putting more attention to official sources. I have a personal interest in this sector and the company so I will make sure to remain objective by presenting a balanced argument which presents other people's opinions as well as my own. Plagiarism can be a danger when using secondary resources, so to address this problem, all sources will be referenced using the Harvard Referencing system - this will enable me to demonstrate the key graduate skill of Referencing which is an OBU requirement.

PART 3

Analysis

Business Description

Dong Energy is a Danish owned energy generating, distributing, procuring and trading company with its operations based in Northern Europe. It was established in 2006 through a merger of six smaller Danish energy companies. Their key objective was to create a balanced energy portfolio and more recently their target became transition to clean energy – mainly wind.

Sector Outlook

Global energy outlook long term offers a number of growth opportunities. Some analysts estimated that energy demand in developing countries will rise 65 percent by 2040 as a result of economic growth and improved wealth per capita (The Outlook for energy: a view to 2040, 2013). That goes in line with the estimate of Population Institute that another billion people will inhabit earth by 2024 (From 6 Billion to 7 Billion, 2011). There is a positive correlation coefficient of 0.8 between the growing population and increase in the prices of oil, which gives indication where the prices of energy are likely to move in the future.

World Population and Brent Crude Oil Price between 1986 and 2010

Year	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
World Population (Billions)	5.0	5.0	5.1	5.2	5.3	5.4	5.5	5.6	5.6	5.7	5.8	5.9	6.0	6.0	6.1	6.2	6.3	6.4	6.4	6.5	6.6	6.7	6.7	6.8	6.9
WTI Spot Price (Dollars per Barrel)	15.1	19.2	16	19.6	24.5	21.5	20.6	18.4	17.2	18.4	22.1	20.6	14.4	19.3	30.4	26	26.2	31.1	41.5	56.6	66.1	72.3	99.7	62	79.5

Source EIA & Earth Policy Institute

Danish presidency of the European Council in 2012 have revealed the main focus areas and just after addressing the need for economic growth and ensuring sound economy, they decided to move their attention to climate, energy and environment. EU has presented the Energy Efficiency Directive aiming to reduce energy consumption by 20% by the year 2020 (Directive 2012/27/EU, 2012).

In the short term energy outlook appears to be more challenging. Current global economic uncertainty has got huge impact on availability and cost of raising finance, especially for companies engaged in investment-intensive transformation. Recent 'credit crunch' entailed lower industrial production and as a result less demand for energy.

With shortage of finance, lower industrial output and lower consumption we can see also lower prices of CO2 allowances.

In Germany, Angela Merkel's plan for taxing nuclear power appeared to be in line with German constitution and European law (World Nuclear News, 2012). Despite the fact that German tax is aiming only energy produced in Germany, the impact will be felt across Europe.

To reduce significant fluctuations in energy prices we noticed higher integration of EU power market causing electricity prices being influenced more and more by the relationship between demand and supply which allows the formation of competitive prices ensuring benefits for consumers.

Dong's Strategic Targets

Dong Energy has set main four financial objectives and has committed itself to achieve them in the future.

Dong had rating of A- by Standard&Poor's and BBB+ by Moody's in 2010 and has been downgraded to BBB+ in 2012. Rating minimum has been set for BBB+/Baa1. As Moody's gave 'Stable' outlook to overall Dong's performance, Standard & Poor's and Fitch gave 'Negative' outlook as a result of 'unsatisfactory financial results in 2012'(Dong, 2012).

Cash resources that should be at minimum level of DKK 11.2 billion (EUR 1.5 billion) were effectively DKK 23.8 billion, DKK 23.1 billion and DKK 25.8 billion in 2010, 2011 and 2012.

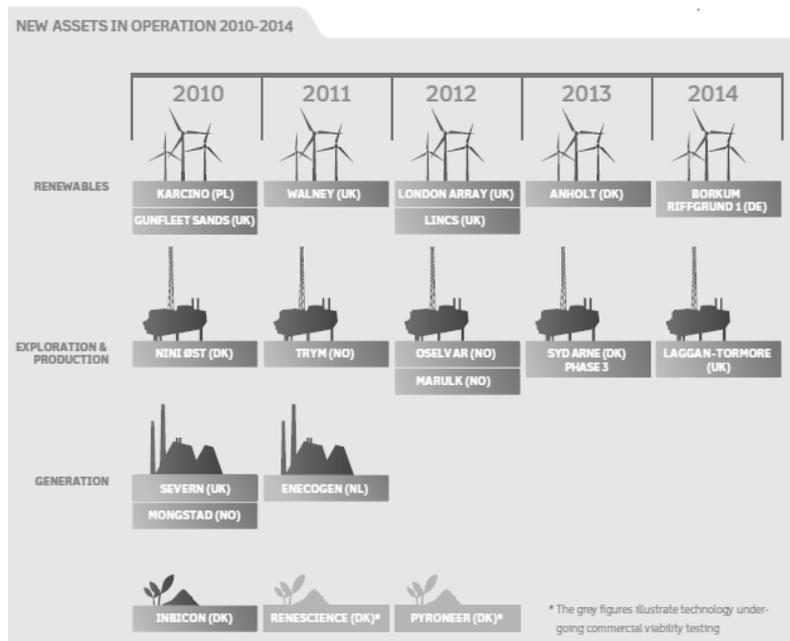
As long as capital structure was stable between 2010 and 2011, staying within a target of adjusted net debt of up to three times cash flows from operating activities, in 2012 adjusted net debt/EBITDA was 4.1.

Dong Energy has got also series of business and strategic objectives that is committed to achieve.

Dong decided to set up a target of reduction CO2 emission and achieve level of 320 g/kWh by 2020. Thanks to heavy investment in wind farms and transition to new bio-technology Dong was able to achieve its goals connected to CO2 emission and reported 524 g/kWh in 2010, 486 in 2011 and 443 in 2012, which brings Dong to review its commitment and set up new target at 260 g/kWh by 2020.

Despite positive achievements in CO2 emission reduction Dong is not able to bring it's new assets into operation as expected.

New assets in operation 2010 - 2014



Source Dong Energy

Walney wind farm is planned to be operational in 2011 and starts sending power to the grid in November 2011. Planning for London Array and Lincs appeared to be less accurate. London Array is operational at the beginning of 2013 (planned 2012), when Lincs is still under construction (Dong, 2012 & Wikipedia).

E&P is in much better position in terms of delivering its assets on time. Trym becomes operational in February 2011, when Oselvar and Marulk became operational in 2012 as scheduled.

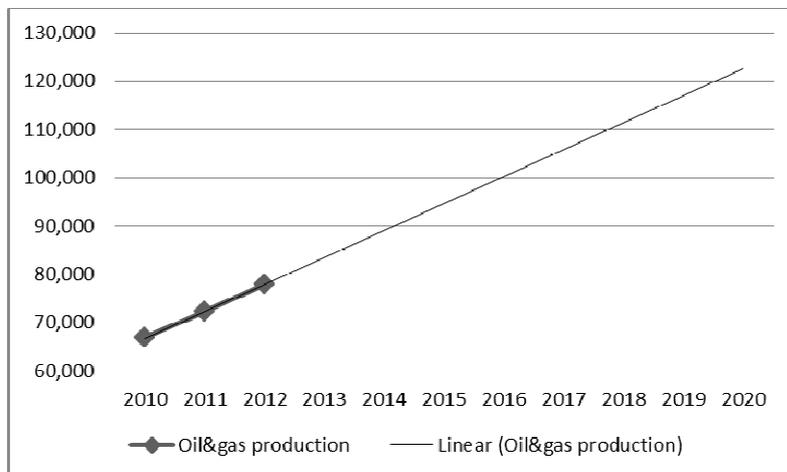
Enecogen becomes operational at the end of 2011 as scheduled meeting Dong's development schedule.

Dong is working to commercialise innovative technologies that could be replacement of coal-fired power plants, and is looking for the long term solutions to reduce even further CO2 emission.

In 2010 Dong set up a target for installed wind capacity of at least 3 GW by 2020, but already in 2012 reviews its goals and reports that will be able to achieve 3.5 GW by 2016.

Dong is aiming to achieve 150,000 boe/day in 2020. Dong managed to achieve moderate growth from around 67k boe/day in 2010 to 78k boe per day in 2012. Looking at the linear forecast it appears that Dong will not be able to reach that goal, and will be closer to 120k boe/day.

Oil and gas production per day (with forecast to 2020)

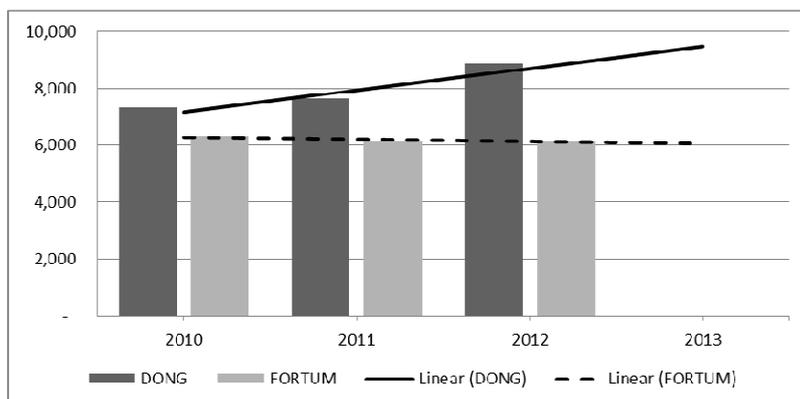


Source Dong Energy

Ratio Analysis

Dong Energy achieved 20.8% revenue growth over 3 years between 2010 and 2012. Between Years 2010 and 2011 increase of 4% reflected higher oil and gas production as well as higher energy prices. Another 2 years brought additional 16.1% increase due to higher gas prices higher electricity sales and income from construction contracts of offshore wind farms.

Revenue Growth for years 2010-2012 and 2013 forecast in EUR millions



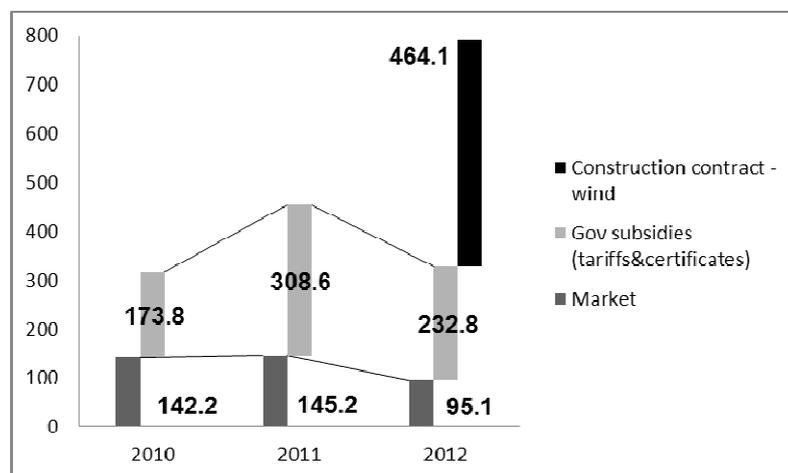
Source Dong Energy & FORTUM

In the same period between 2010 and 2012 Fortum experienced negative revenue growth of -2.2%.

One of Dong’s financial objectives was to double EBITDA between 2009 and 2015. That sets a target of 1,377 million euro 1,578 million euro and 1,769 million euro for 2010, 2011 and 2012 respectively. As long as targets for first two years were overachieved by more than 30%, Dong did not achieve its target for 2012, and meet only half of expected EBITDA.

Over analysed 3 years Dong Energy experienced revenue growth in most of the reported segments. Wind energy amounted to 150.5% revenue growth over a three-year period. However in 2011 2/3 of the revenue came from government revenue schemes. This repeated in 2012 and the increase in revenue is composed mainly of income related to contracts for the construction of the offshore wind farms.

Wind Revenue growth 2010-2012 (in million EUR)



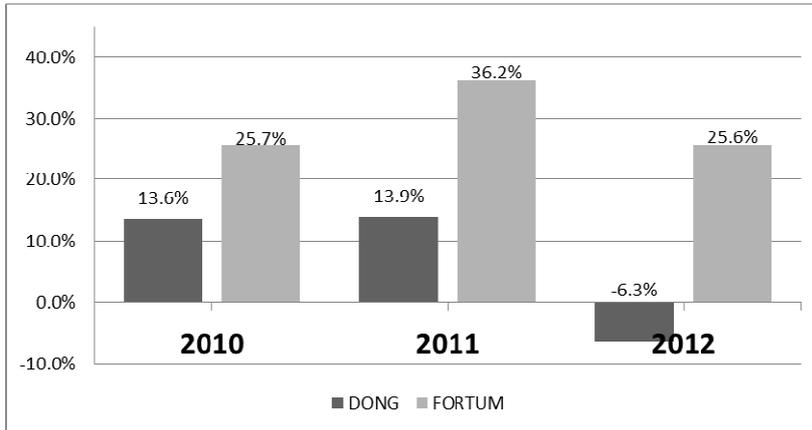
Source Dong Energy

Organic 'growth' (after deduction of contracts and governmental subsidies) falls below zero and amounts to -33.2% over three-year period.

Dong's net profit margin is stable between years 2010 and 2011 at the level of 13.6% and 13.9% respectively and falls below zero to -6.3% in 2012. In 2011 revenue shows positive growth of 7.3% when EBITDA grows by 11% mainly due to minimal increase in cost of sales and other expenses.

As a result of heavy investments, depreciation in 2011 increases by 28% which is offset by increase in finance income giving 6.2% profit before tax. In 2012 revenue continues to grow, but Dong seems to be losing control over cost of sales, which increases by 51% when revenue grows by 12.4%. Despite 203% growth of other operating income, EBITDA is down by nearly 55% comparing to 2011. From that point Dong shows even poorer results. Heavy investment year increases by 60% depreciation and amortisation bringing EBIT to -162.3% comparing to 2011. Disposal of enterprises increased by 1085% year over year, this however didn't substantially improve profit before tax staying at -152.8%.

Net Profit Margin 2010-2012 (%)



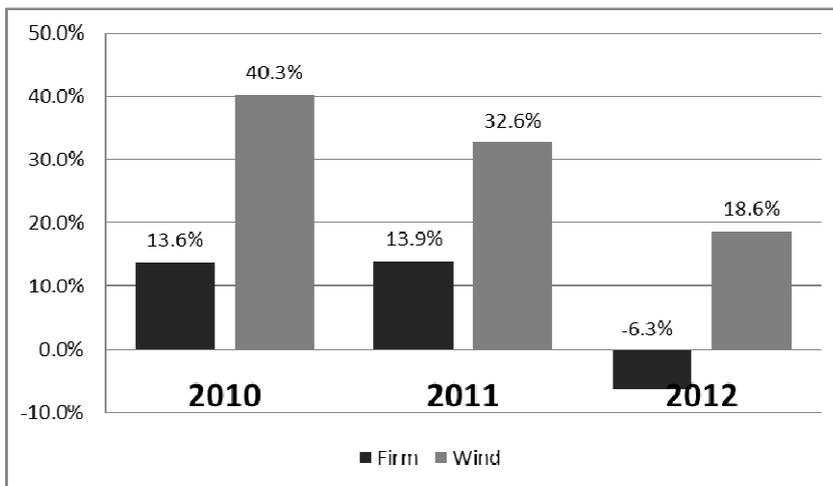
Source Dong Energy

Net profit margin of Fortum is growing from 25.7% in 2010 to 36.2% in 2011, after which falls to 25.6% in 2012.

As a result of meeting only half of targeted EBITDA in 2012 Dong did not achieve its financial objectives for net profit margin which I assume should stay at 14% level as in the previous years and shows negative net profit margin due to losses for this year.

Net profit margin for Wind is down from 40% in 2010 to 32.6% in 2011. This negative trend follows in 2012 and net margin falls to 18.6%.

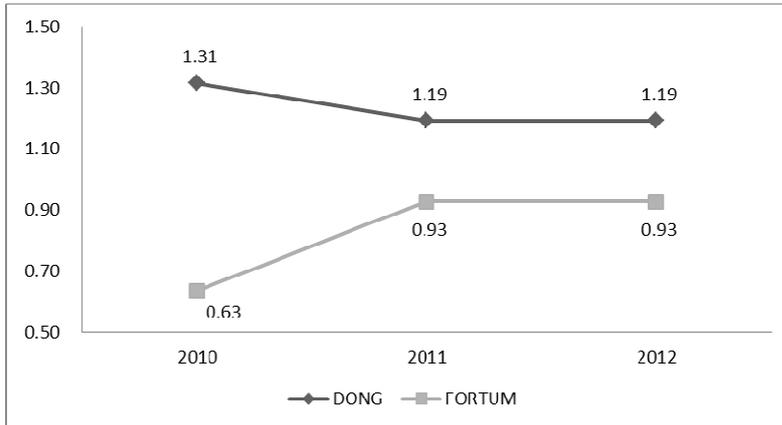
Net Profit Margin DONG (firm-wide) vs Wind segment (estimate)



Source Dong Energy

Quick ratio for Dong Energy is down from 1.31 to 1.19 between 2010 and 2011 due to increase in current liabilities in 2011 as well as increase in inventory. Dong managed to keep quick ratio unchanged between 2011 and 2012.

Quick Ratio

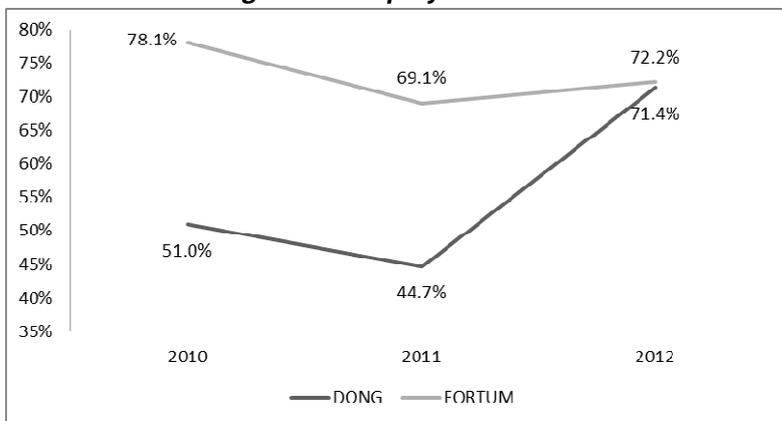


Source Dong Energy & FORTUM

Fortum's Quick Ratio improved from 0.63 in 2010 to 0.93 in 2011 and stays at the same level of 0.93 in 2012.

Debt to equity ratio in 2011 is down mainly due to repurchase of hybrid capital bringing down adjusted interest-bearing net debt. Dong simultaneously shows 12.5% increase in equity. Despite of the increase in hybrid capital DKK 8,088 million in 2010 to DKK 9,538 million in 2011, Dong recognises only part of its hybrid capital as interest bearing (DKK 2,206 million) and defers further DKK 2,564 million of interest bearing condition to credit rating of Dong Energy AS. That deferral did not however help achieving better results the following year. In 2012 gearing is up to 71.4%, a result of much lower cash flow from operating activities higher net investment, dividend and hybrid coupon as well as losses for the year reducing retained earnings and bringing equity down by 13.4%.

Net Interest-bearing debt to equity

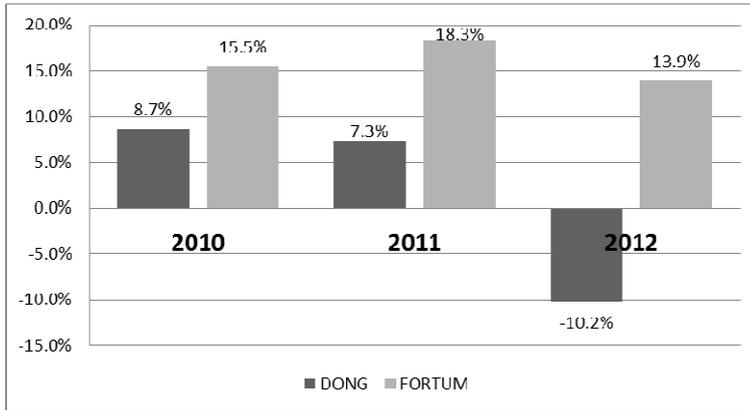


Source Dong Energy & FORTUM

FORTUM has shown more stable trend, with volatility within 5% range, when Dong Energy ratio is up by nearly 30% between 2011 and 2012.

Return on Equity for Dong is 7.3% in 2011, down by 1.4% on 2010, driven mainly by much higher rise in shareholder's equity in comparison to decrease in profits in 2011. In 2012 shareholder's equity is down by 13.9% and Dong reported losses for the period, resulting in ROE falling to -10.2% in 2012.

Return on equity

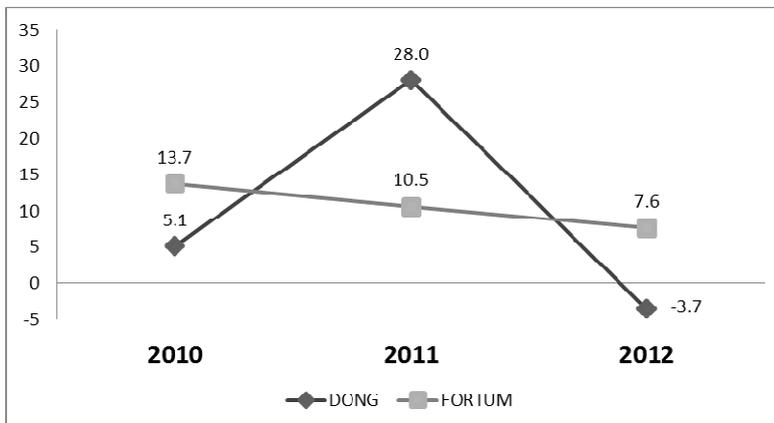


Source Dong Energy & FORTUM

FORTUM's numbers reveal healthier results in ROE. Profits are up by 37.5% in 2011 and we observe only 16.2% increase in shareholder's equity causing ROE to be 18.3% for this year. Subsequent year ROE shows slight decline to 13.9% due to fall in profits.

Interest cover fluctuates for Dong Energy between 5:1 in 2010, 28:1 in 2011 and -3.7:1 in 2012. Unusual rise in interest cover in 2011 is due to fluctuation in net interest in 2011 and effective fall from 214 million Euros to 38 million Euros with stable profit before tax. Interest cover falls to -3.7:1 due to loss and rise in net finance cost in 2012.

Interest cover



Source Dong Energy

SWOT Analysis

Dong is unquestionable leader in offshore wind farms and is already responsible for 38% of European wind capacity (Dong Energy, 2012). Danish company also managed to increase its gas and oil reserves (2P) from 446 million boe in 2010 to 454 million boe in 2012, equivalent to 15 years' production.

Dong developed three different technology solutions that were the focus points in growth of biomass and waste to energy (Inbicon, REnescience and Pyroneer). Dong Energy is also in avant-garde proposing Smart Grid designed to guarantee flexibility in energy consumption.

In order to secure its market position, Dong made a significant effort to expand its European presence which came with geographical diversification. Between 2010 and 2012 Dong's Intangible assets together with PPE in Denmark changes from 52% to 42% of total amount and proportion of revenue by region falls from 57% for Denmark in 2010 to 41% in 2012 (Dong, 2010&2012).

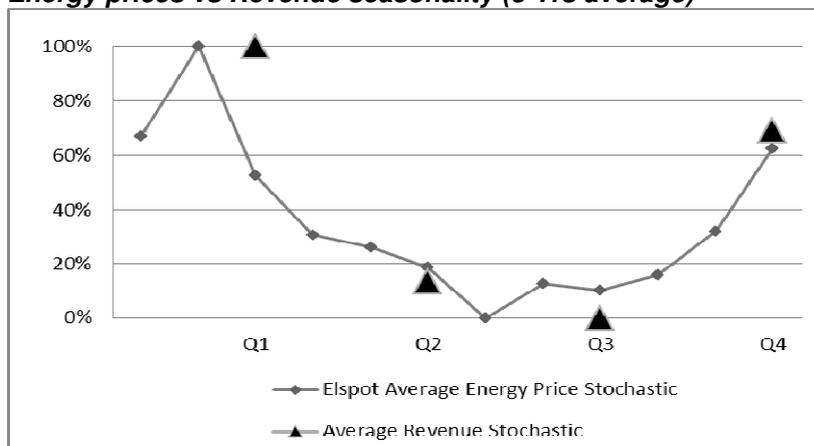
Next to its strengths Dong is also facing weaknesses. Majority (around 70%) of oil and gas production is coming from one site Ormen Lange in Norway (Dong, 2012), which makes Dong hugely dependant on the success of that site in E&P business unit.

Profit that is earned from wind energy in 2/3 is supported by government subsidies and it may turn out to be risky investment if local governments will change its green policies.

Despite of the challenges, there are number of opportunities that Dong Energy may profit from in the future. As a result of Kyoto Protocol and accelerated by recent Fukushima nuclear melt-down, market recognised greater demand for 'green' energy. Angela Merkel's plan for taxing nuclear power appeared to be in line with German constitution and European law (World Nuclear News, 2012), which opened a way for expansion of Dong's business. Acquisition of Shell Gas Direct in 2011, construction of London Array offshore wind farm together with number of other investment programmes became a definite statement that Dong is prepared to enter the UK market. That will further bring Dong series of opportunities and most likely Exploration & Production discoveries in the near future. Recent trend towards hybrid and electric cars as well as electricity prices burden taken by consumers will require Smart Grid solutions and Dong Energy can be one of the first providers of flexible electricity solutions. Thanks to new technologies Dong is seizing the rising waste market and embraces possibility of creating power from waste and biomass. Dong is engaged in development of three independent bio-refining technologies which is a focus point of 2020 strategy.

Dong Energy is facing a number of threats that can undermine the achievement of its goals and destabilise potential growth opportunity. Revenues depend on series of factors, but the main would be fluctuation of energy prices at Noord Pool market, which again are connected to the weather and temperature (revenue increases in cold months).

Energy prices vs Revenue seasonality (3 Yrs average)



Source Dong Energy & Nord Pool Spot

In the recent years Dong suffered losses on long term gas contracts due to huge fluctuations of oil indexed gas and gas spot prices. If the spread continues to increase there will be very little real advantage of entering into long contract gas agreements, which as a result can dramatically change volatility of spot gas prices.

Recent economic uncertainty in Europe give very little promise to sudden rise of energy demand. That can be a substantial threat to expectations of continued growth, which can be observed in the last three years of Dong's performance. Recent oversupply of CO2 allowances (Sustainability report, 2012) creates additional pressure on green energy providers. Dong will be facing greater competition, as the number of companies operating in energy sector is growing in Europe.

Most likely nuclear fusion energy is not going to create immediate threat to renewable energy sources in the short term, but the development of ITER will most likely change the outlook and soon after, the balance of energy production after the successful achievement of first plasma, which is scheduled for 2020.

PESTEL Analysis

Political

Despite the fact that current target for EU is to generate on average 20% of energy from renewable sources Germany has already set up a target for 2050 and has committed itself to produce 60% of renewable energy by 2050 (Buchan, 2012). That shows the future trend in the EU policies and create positive environment for companies investing in renewables.

When CO2 allowances were discussed some analysts were expecting that price per tonne of CO2 will reach on average €35 (The Cost of Generating Electricity, 2004), but with current oversupply and low price of allowances we may be facing changes in EU policies to further bust the financial feasibility of renewable energy projects.

Currently 2/3 of the revenue from Wind division of Dong is coming from governmental subsidies. There is no indication that these will change, there is however substantial risk that if feed-in tariffs will be no longer funded by governments, wind division will reduce margins or end up making losses.

Economic

Slow global recovery can already be reflected in the prices of oil. Only in 2010 prices of Brent Crude Oil rose from \$69.92 to \$92.45 (Oanda, 2013), and had been volatile since. Oil indexed prices can bring greater divergence to gas spot prices reducing margin of Dong.

Further to that substantial rise in energy prices over last 120 years in Europe as a result of an attempt to privatize the sector can create less demand for constantly rising cost of energy and add to oversupply of energy at European markets.

Rising new funds appears to be difficult and more costly. Hybrid capital issued in January 2011 has got fixed interest rate of 7.75%, compared to 5.5% for bonds issued in 2005.

Social

Population globally is estimated to grow (From 6 Billion to 7 Billion, 2011) to 8 billion in next 11 years. Considering that nearly 1.5 billion people is living without electricity (Fortum Annual Report, 2010), growing population and improving standard of life will increase the demand for more energy globally.

Germany already agreed to phase out its nuclear energy by 2022, and now following its neighbour, François Hollande in his campaign said that he will be looking to reduce share of nuclear electricity from 75% to 50% (Buchan, 2012) which in the near future will create extremely positive environment for companies that are leaders in green energy solutions.

Technological

Favourable environment allowed Siemens to focus on improvements of the wind turbines aiming at cost reduction in maintenance and greater electricity output. New gearless drive technology developed by Siemens will secure greater energy yield with less maintenance cost (Dong, 2012).

Thanks to the well-chosen strategic alliance with Siemens, acquisition of A2SEA gave already a solution that will bring down the cost of installation of the wind farms. New vessel that will be able to carry more wind farm bases will be delivered in 2014 and as Dong is estimating that “wind energy can become 30% cheaper” (Dong, 2012).

Legal

Current tax hydrocarbon tax depends on Member States. If these will be looking for more income to tackle debt crisis, governments can increase taxes in a desperate search of funding. In the same time there might be an opportunity in more liberal energy market in Russia and in increasing liquidity of energy market that could push down hydrocarbon tax in Norway resulting in improved profits.

Ecological/environmental

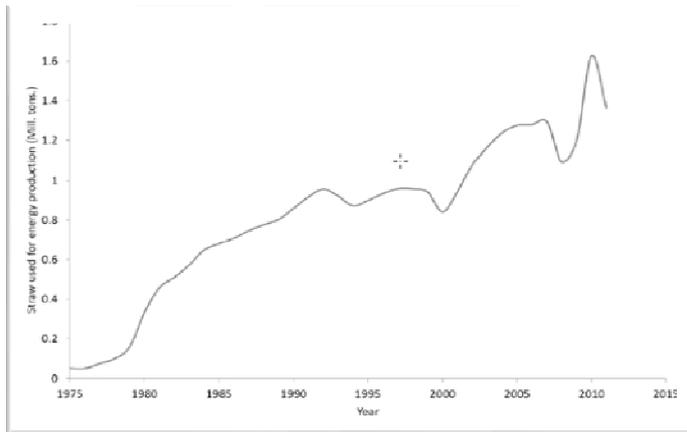
Wind energy has limited harmful effect on the environment and contrary to fossil fuels emits no air pollution when operating.

Dong’s continued effort to reduce its CO₂ emission will gain more of the green market share and will ultimately contribute to revenue growth.

The decline of CO₂ from the energy production means for Dong less reliance on persistently falling coal prices hitting new 44-month low in August 2013 which will squeeze the profit margins.

The transition to straw-based energy is posing new challenges and questions.

Straw use in the Danish energy sector 1975-2011



Source University of Copenhagen, Department of Geosciences and Natural Resource Management, 2013

Constantly rising demand may push the prices up, which are already high – 100 USD per tonne. Some analysts estimate, that to cope with greater demand for straw Denmark would have to provide additional 10 million tonnes of biomass annually by 2020, which in side effects can impact soil degradation and create threat to future crop yields.

Conclusion

In the context of above findings I can conclude on the questions posed at the beginning of the research report.

How has DONG Energy performed compared with FORTUM?

Despite the geographical and revenue growth which indicates overall expansion that gave Dong a position of leader in wind energy, financial performance of Dong Energy results in losses for 2012, when Fortum shows improvement in profit after tax in the period 2010 to 2012. Dong's is well positioned considering that EU will continue its green direction in recognising greater need for more renewables, which will give Dong even greater number of construction contracts and revenue that goes with it. As there is no immediate threat from any other renewable technology, wind will remain the main source of 'green' energy for Europe.

Dong also reports worsening profit margin which came with the lost control over expenses in 2012, slower economic recovery and not delivering assets on time, while Fortum shows moderate improvement in 2011 and three-year stable margin level of 26%.

While Fortum managed to cut on liabilities and improve quick ratio between 2010 and 2012, Dong is reporting rise in liabilities and falling ratio for the same period.

Facing investment intensive time and difficulties in rising finance debt to equity ratio for three year period is deteriorating whereas Fortum's gearing is improving.

Being exposed only to one geographic region and more unified energy market and as a direct result of high cost of energy production, ROE for Dong is only half of what Fortum is showing for 2010 and turns for Danish company negative in 2012. Fortum's ROE is less

volatile and stays on average at level of 16% balancing its European losses with profits from Russia.

Geographic expansion together with higher cost of debt and losses for 2012 caused Dong Energy's interest cover falling to -3.7 (from 5.1 in 2010) while Fortum's interest cover declined from 13.7 in 2010 to 7.6 in 2012.

Financial performance of Fortum appears to be more appropriate, considering difficult external economic conditions and energy market changes. Fortum takes prudent approach cutting costs which results in better profits after tax. They focus on emerging Russian market which gives positive balance to moderate losses from European region.

Dong Energy took substantial amount of risk focusing on renewables and investing heavily in wind energy. That came together with testing new bio-technologies, which also created further financial uncertainty. Dong is trying to mitigate the risks that is facing and 'assembly' line concept which may bring benefits long term, in the short term however they are not able to bring wind farms to operational state on time and as a result profits are not rising in line with revenue. Questionable is at which state wind energy will become profitable without subsidies. As shown in the study, the main part of revenue is not organic and requires grants to make it profitable. The transition brought more costs resulting in declining margin and with over-optimistic planning that added 100% to depreciation over three years. I conclude that over the period of three years 2010 to 2012 Dong Energy did not perform better than Fortum.

To what extent has DONG been able to achieve its strategic goals?

Danish company set up series of strategic goals that are in line with recent developments in energy market. They quickly acknowledged the opportunities that exist in growing demand for 'green' energy and immediately came up with the solutions offering reduction of CO2 emission and transition to wind power. Additionally Dong could welcome the news of nuclear phase out in Germany opening new market for wind. Together with wind Dong developed new technologies and is preparing itself for next stage, that could come in 10-20 years when excessive use of electricity will require smart grid solutions balancing energy deficits from wind. Dong Energy did not meet all of its strategic objectives that were set up for financial and business performance. I have to note that some of these targets aiming at 2020 and to be able to assess the achievements I had to make linear adjustments, to be able to find equivalent target for 2012. Main reason for not achieving all of its targets is rapid transition to green energy and delay of returns from new assets that brought unsatisfactory financial results. I have to recognise that A2SEA and new vessel can solve few problems – it will increase the construction speed and reduce the cost. Wind being the driver of 'green transition' is also showing shrinking net profit margin, and together with rising cost of new finance the transition seems to be poorly managed in the context of slowly recovering economy. Dong kept its position of the offshore wind farm leader but they placed themselves in financially unsustainable position.

How much transition to wind energy allows meeting strategic objectives of DONG Energy?

Revenue growth indicates that Dong took strategically the right direction, following the trend towards green energy and tapping into governmental grant in few countries, but the speed of transition appears to be damaging financial performance. Investment in wind energy as well

as strategic alliance with Siemens gave Dong market domination and well deserved leadership in offshore wind in Europe becoming present in number of European countries. Thanks to the higher 'green' energy output they reviewed CO2 emission targets that resulted in even lower number that can be achieved by 2020. Growth in revenue is also a good indicator that Dong raises to the challenge of the current demand for sustainable energy and considering that fusion will become a threat only in 10-20 years the long-term strategic forecast for Dong is positive. As far as transition to 'green energy' allows meeting most of 'environmental' and business objectives, it also creates obstacle in achieving financial targets. Higher costs and losses for 2012 are directly connected with the green transition and it will require from management detailed review of company's expenses and radical cuts if Dong is to regain its profits in the years to come.

Recommendation

Dong Energy despite the short-term difficulties is following the energy trend for Europe. I believe that with the rational cuts in cost Danish company can improve its operating profits that will also recover with the introduction of new vessel from A2SEA. We cannot forget that wind amounts only to 9% of revenue, and that is not the main revenue driver. Greater spread in oil-indexed gas prices will force companies to trade at spot prices, which can result in price seasonality, but can secure improved margins. Furthermore Dong should continue entering into strategic alliances in research and development in order to diversify the risk it is taking. Danish company relies on one Norwegian oil and gas extraction site and it is of vital importance to reduce that dependency by looking for profitable sites outside of Norway. It may be necessary to divest some of the less profitable power units to bring healthier results next year. Dong Energy is making decisions that are in line with social and ecologic trends and I estimate that it will give Dong competitive advantage entering UK and German market.

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