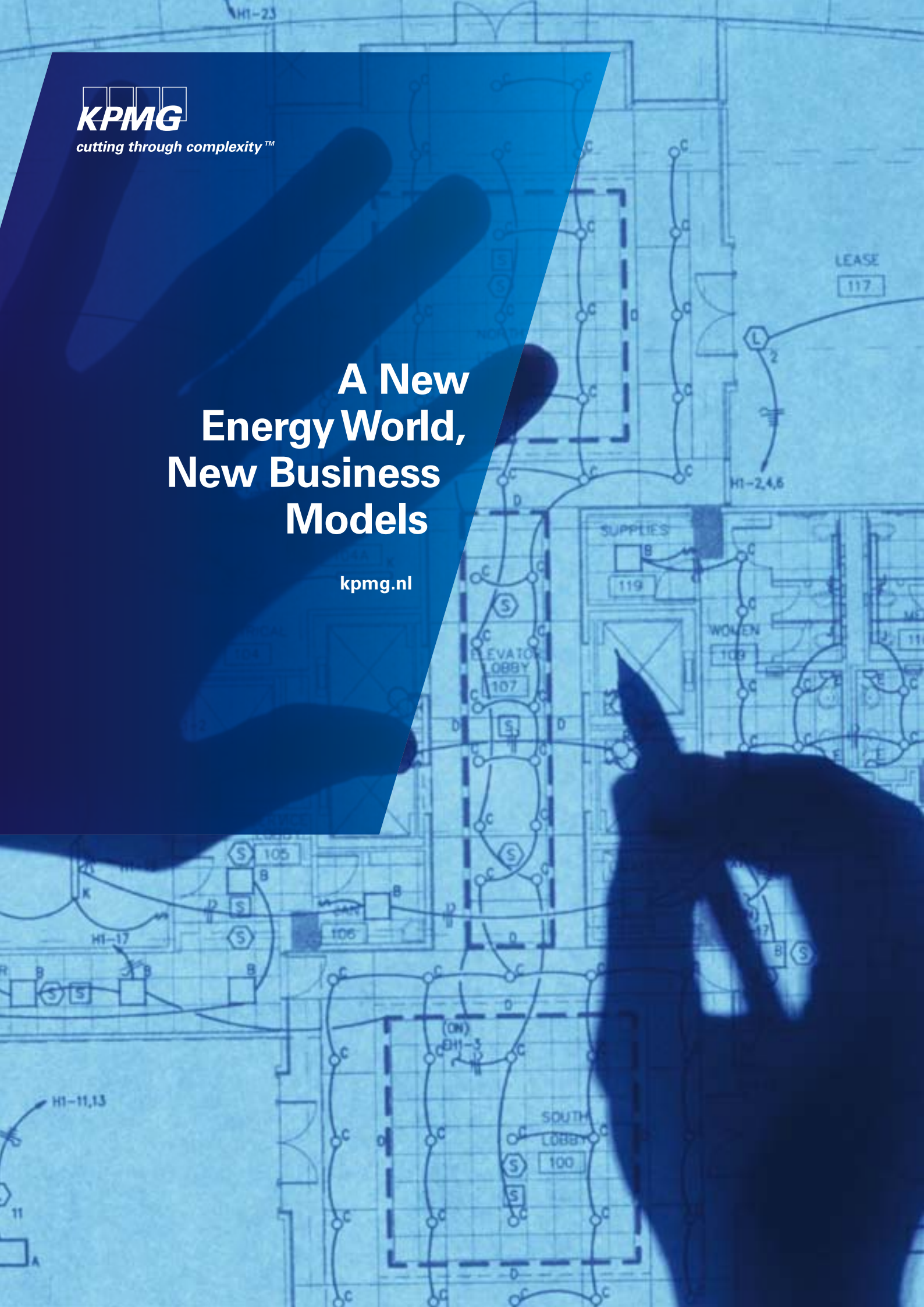




cutting through complexity™

A New Energy World, New Business Models

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The energy world is continuously evolving and developing. In this environment the only certainty is that a totally new energy landscape is about to emerge. The global need for energy continues to increase, both in the western world, as a result of the demand for higher standards of living, and in the emerging economies, as a result of accelerated growth. It has also become increasingly clear that alternatives to fossil fuels are required. Our global reserves are rapidly declining and their use leads to worldwide environmental problems.

Various technologies play a part in the transition to an energy world where sustainability plays a central role. It is very difficult to predict which technologies will be tomorrow's champions. It seems certain that not only the technology will change but also the business itself. During the next decades other business models will come into existence, new players will emerge and private citizens will not only be energy consumers but also producers.

This vision paper provides an insight into the most significant changes that await the energy business. The content is based on the results of an online survey taken with approximately 200 energy professionals, in-depth interviews with ten thought leaders from the energy world and the in-house knowledge and experience of KPMG.

1.1 Background and approach

As an advisor, KPMG has a strong position in the energy sector we find it very important to keep extending our knowledge within this constantly changing market in cooperation with our business relations. During April and May 2011, together with KEMA NV, we conducted a survey into the most significant developments and the influence that these developments may have on the current energy sector. We developed an online survey which we

distributed to 689 energy professionals by research agency MWM2. 193 of the professionals polled completed and returned the questionnaire (a combination of open and closed questions); an overall response rate of 28%. In addition we interviewed 10 thought leaders from within the sector. They helped us form and create a relevant questionnaire and also assist us with the analysis of certain market developments. I would like to take this opportunity to thank each of them for sharing their knowledge and vision via the online survey and for participating in the one-on-one interviews.

Subsequently, you will find hereafter:

- Chapter 2, an overview of the research results from the 193 energy professionals who responded to our survey.
- Chapter 3, our vision of how the transition will impact upon the current energy sector business (models). A summary of this chapter has been published in 'Het Financieele Dagblad' dated 9 June 2011.
- Chapter 4, our thoughts on how we can advise companies that are active in the energy sector in anticipation of the energy transition.



Hans Bongartz
Partner and sector leader
Energy & Natural Resources
KPMG The Netherlands

1 Introduction



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Contents

The rise of new energy technologies makes predictability largely disappear

- Almost two third of those that responded to our survey felt that frontier innovation will not come from the large energy companies
- Three quarters of the respondents held the opinion that co-operation within the value chain should be central in the transition to a new energy world
- Three quarters of the sample felt that the government may force the market to reduce energy consumption, because market players would appreciate this.
- Over three quarters of the respondents thought that encouraging saving energy in the immediate future, was a more attractive strategy than investing in new renewable sources of energy, as this strategy requires far less investment.



2.1 Big uncertainties

It is a common cliché to say that the future is uncertain. However, it is also a fact that growing uncertainty is quickly becoming a big issue in the energy world. Traditionally, energy companies invest in power stations and grids, with clear expectations and prognoses based on consumer demand that is more or less predictable in the long-term. Due to the rapid rise of new energy technology, that traditional predictability has largely disappeared. Creating a realistic strategy for the long-term has therefore become increasingly difficult.

The share of decentralised generated renewable energy (by so called prosumers) in 2025 has become an important indicator of possible scenarios. The survey showed that 8% of the respondents expected that this share would be less than 5%. 36% felt that the figure would be between 5% and 10%. However, 34% of the respondents felt it more realistic to be between 10% and 20%.

Directly related to this question, is the question of the achievability and desirability of investment in conventional power plants. Only 28% of the respondents (a minority opinion), actually felt that this should be stopped, because for energy from these plants would decrease, as decentralised generation will grow in the future. The majority opinion (46%), believed that replacement investments were necessary and should continue. Only 26% of those answering selected the 'neither agree nor disagree' option.

The uncertainties and discord within the market were further illustrated in answers to other questions. The future role of China was a good example. 43% of respondents thought that China would not be the most important global supplier of renewable energy in 2025. However, 31% thought it would be and only 26% opted to 'neither agree nor disagree'.

However, regarding some issues, a consensus of opinion does exist. Three quarters of the respondents hold the opinion that co-operation within the value chain would be central to the transition to the new energy world and again three quarters felt that the government may force the market to further reduce energy consumption, because market players would appreciate this. Furthermore, almost two thirds thought that frontier innovation would not be driven by the large energy companies.

2 Summary research results

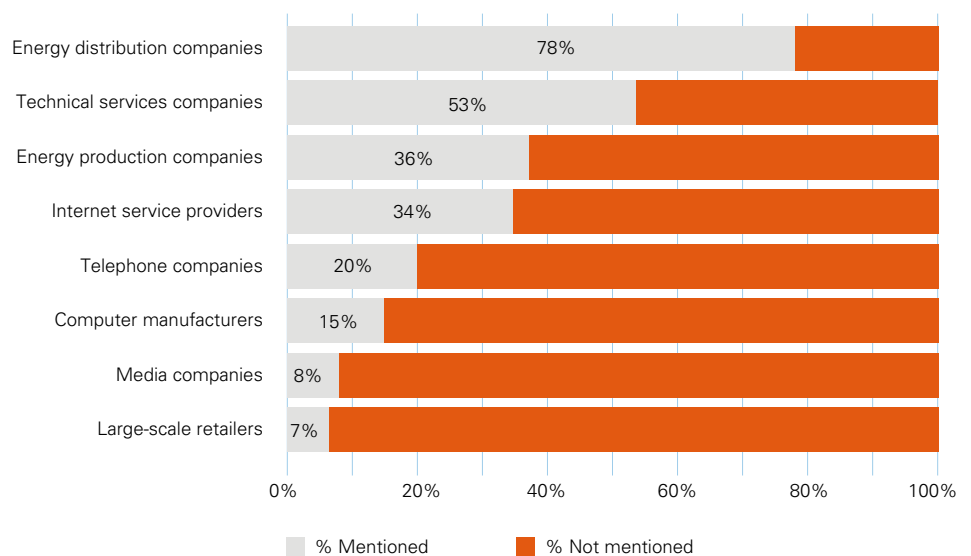
2.2 Smart grids offer opportunities

Smart grids are infrastructures (for electricity, gas, heat, cold), which are provided with measuring and settlement applications. These smart grids allow the pooling of decentralised generated energy between citizens but they also offer many other significant possibilities and opportunities in the long-term. Various new services will be possible once there is a smart grid and the data that is obtained through this grid can be 'the new gold' for companies.

Slightly more than half of the respondents felt that this will be the case. The companies that will profit most from the smart grids and the smart meters in the energy consumer market would, according to the respondents, primarily be the energy distribution companies (78%) and to a lesser extent (53%) technical services companies. In answer to the question, will smart grids will have a major impact upon the existing business models of the energy sector, 54% of respondents felt that this would be the case. (Graph 1)

One of the big questions the energy sector needs to confront is how the new propositions can be marketed. 54% of the respondents agreed with the statement, that in the business models of the new energy world, increasing the quality of life would be the key element (e.g. offering mobility, delivering comfort), instead of just purely delivering energy. 22% opted 'neither agree nor disagree' and the remaining 24% did not agree that this in fact would be the case.

Graph 1



Capital is required to make the transition to the new energy world

When marketing the new energy services, the electric car may play an important role in the future since the 'holy cow' has a high emotional value for consumers, contrary to energy. 58% of the respondents held the opinion that the electric car would be the best marketing vehicle for 'renewable energy'. Only 13% did not agree with this sentiment and 29% opted 'neither agree nor disagree'. (Graph 2)

The automotive industry was also highlighted as market sector which could profit greatly from the new smart grids.

2.3 Financing is a difficult hurdle

In order to make the transition to a new energy world possible, capital will be required. This is equally true for both investments in (decentralised) facilities to generate energy and investments in (inter)national infrastructures. With respect to investment in facilities, currently there are talks in the market regarding the potential of Energy Service Companies (ESCO), to provide development, maintenance, exploitation and financing for both companies and

private citizens. In this model, the energy savings and/or profits of these installations are shared by ESCO and its customer. The majority of the respondents (53%) do not think that the rise of ESCO's will really be a major factor in the next three years. However, 22% disagreed and felt that they would. (Graph 3).

Many respondents expect that the financing of the infrastructure required for both electric cars and smart grids will be a major hurdle in the energy transition. 53% agreed with the statement that this would be one of the most significant hurdles to cross en route to a new energy world. 32% disagreed. (Graph 4).

Graph 2

The electric car is popularly perceived as the 'renewable energy' marketing vehicle of the future.



Graph 3

The rise of the Energy Service Companies will be a major factor within the next three years.



Graph 4

Financing the infrastructure for the smart grids is the most significant hurdle en route to a new energy world.



■ % Strongly disagree ■ % Disagree ■ % Neither agree nor disagree ■ % Agree ■ % Strongly agree

Many respondents felt that ultimately it will be about price and comfort

2.4 The consumer remains particularly interested in the cost

Opinions remain divided when it comes to ways of stimulating consumers to use less energy. A slight majority (54%) did not believe that consumers will regard energy consumption as an interesting 'game' to be played using games, apps and other (technological) applications. In their responses to the open questions, respondents felt that it was important to involve the consumer more, for instance, by making the consumer aware of the consequences of high energy consumption. Energy is a commodity that people take for granted. Currently, energy does not have an emotional value. Many respondents point out that ultimately it will come down to issues of price and comfort. The willingness of the consumer to pay extra for renewable energy will in part depend on the answer to the question of whether decentralised generated energy will reduce comfort.

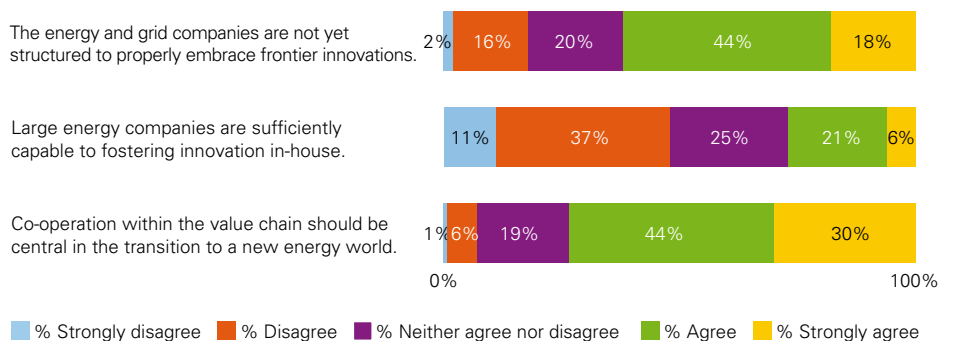
2.5 Large energy companies are not big innovators

A substantial percentage of the energy professionals who responded (48%) did not think that the large energy corporations were capable of adapting to the new energy world. However, 27% disagreed and thought that the large energy corporations were capable of successfully making the transition. The majority (62%) of respondents also agreed with the statement, that the energy and grid companies were not yet structured to fully realise frontier innovations. A deeper analysis showed, that the Oil & Gas and Power Generation markets shared the same vision. 74% of respondents also felt that partnering with start-ups and other cutting edge

businesses was a good strategy for the large energy companies to encourage and foster further innovation. (Graph 5) Thus, scale size is combined with guts and innovative strength. The sorts of business and institutions mentioned as potential partners include technical services companies, engineering companies, universities and suppliers. In addition, ideas incubators were also mentioned as a possible means to grow and embrace innovation.

According to a number of respondents, the role of the government is essential in promoting innovation and many feel that more focused subsidies are required in this area. Some feel that the government can actually force energy companies to innovate.

Graph 5



2.6 The role of government

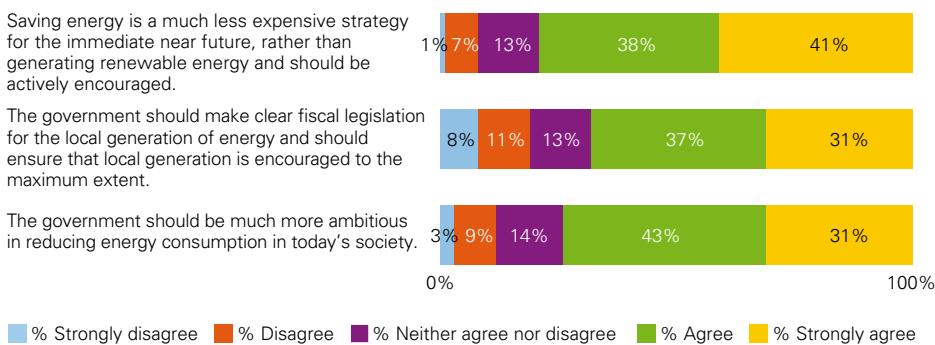
74% of respondents agreed that the government should be much more ambitious in actively encouraging to increase the efficient use of energy in today's society. The respondents also feel that the possibilities to save energy are underestimated. 79% of the energy professionals who responded, also agreed that saving energy will be less expensive than generating renewable energy in the near future and they felt that these efficiencies should be aggressively stimulated by government if need be. With respect to the local generation of energy, 68% felt that the government should set clear fiscal legislation and should ensure that the local legislation is also encouraged. A deeper analysis showed that company board members were even more firm on this point than the governmental policy advisors. (Graph 6).



Respondents also felt that the government should have a coherent sustainable energy policy. The government should also strongly emphasise the urgent need for sustainability and simplify procedures/legislation. There should be a policy aimed at

'realistic sustainability' which requires discussions at a European level, on issues that include a.o. the investment climate and safety. An essential prerequisite however are: visionary politicians who are willing to stick their necks out.

Graph 6



Facilities producing 'renewable energy' will only become an important factor, when the cost per energy unit produced, can directly compete with the price of energy produced from traditional fossil fuels.



Through the use of sustainable technology, private citizens and companies in the future will generate a large part of the energy they use themselves. They will also settle outstanding balances via smart grids and meters. What does this new model mean for the existing energy sector? There really are no certainties but based upon the in-depth interviews we conducted and our own research, we can sketch the possible developments and changes facing today's energy world.

The year is 2025. The neighbours' house provides inexpensive power to the district's grid because the neighbours are away and are therefore generating surplus power from their solar panels. This is a signal for the washing machine to profit directly and start a laundry programme. In the meantime a micro WKK installation in the attic very efficiently generates power from biogas and uses that to charge the electric BMW car of a visiting friend. The intelligent grid arranges that the costs for charging her car are automatically debited from her account.

Is this the daydream of a burned-out trend watcher or actually a realistic scenario? If we look at recent history it could take longer than we think. Take for example the computer mouse. After its invention it needed 30 years to conquer the world and no one will deny that it is a wonderful invention. The pace of the transition to a new energy world is hard to predict but it seems certain that decentralised generation and smart grids will play an important role. At this moment there are more questions than answers. What does this mean to today's energy sector? What role will government play in this transition? How can we create sufficient capital? And what other hurdles will need to be taken?

When we speak of hurdles, there remain some important technological issues that need to be addressed. The battery life of an electric car is a very simple but good example. Only when they have a larger storage capacity and can be charged quickly and conveniently, will consumers start experiencing ease of use and a true breakthrough becomes possible. A less familiar technical challenge regards the construction of grids capable of transporting high voltages. It is to be applauded that private citizens will generate part of their energy requirements themselves but it seems almost certain that a large part of the 'renewable energy' needed will still be produced by large-scale installations.

This requires a totally different way of thinking. Power stations have traditionally been located in close proximity to the place where there was a demand for their energy. Large-scale power generation through wind, sun and other renewable energy sources is now of course generated in the regions where the wind blows the hardest or the sun shines the brightest. The resulting consequence is that large investments will have to be made in high-voltage grids to facilitate transporting the energy across large distances. In addition, this also requires the collective will to collaborate internationally: the larger

the region in which energy transition is dealt with, the better the various renewable sources of generation can handle the peaks in energy demand. Regions with various characteristics and time zones can thus create a buffer for each other.

From an economic perspective, there are also large hurdles to take. Facilities producing 'renewable energy' will only become an important factor, when the cost per energy unit produced, can directly compete with the price of energy produced from traditional fossil fuels. That is of course not a fair comparison, because we then also should consider the damage done to the environment, caused by the use of fossil fuels to generate energy. Hard global agreements concerning the pricing of CO₂ emissions could solve that but that seems to be utopia. After world leaders again failed to force a breakthrough with an ambitious climate agreement in Copenhagen in 2010, worldwide awareness is growing that the solution will not be found by a global political approach. Global governance cannot be achieved on this issue, because in a worldwide market, countries are competing and they are tempted to protect their own national interests with flexible sustainability norms and fiscal rates.

3 A vision on the energy transition

The big winners will be those parties that can bridge these (cultural) differences

In addition to the economic rational, renewable energy also suffers from a serious marketing problem. Many consumers are just not sufficiently concerned with how their energy is produced and do not find it to be an important issue. The criteria used when choosing the latest designer kitchen, are very different from those used when deciding whether or not to install solar panels. That is quite understandable but in order to boost decentralised generation, it is necessary to really reach the consumer. The marketing possibilities are almost endless, everything from the naming and shaming of households who do not live in a sustainable manner, to the development of a mobile phone App that is directly linked to the energy meter.

A major breakthrough of the electric car would be a great help in this respect, as it is really usable as a marketing vehicle.

In a more abstract sense, new business models and co-operation within the value chain need to adapt and evolve to reflect the changes in social structures because the new energy world also has a human sociological component; the definition of a 'good life' will change as other values become more important and the consumer will not only be a consumer but also a financier and producer of energy. Companies need to rethink how they answer the question how to add value for this 'new' consumer. For this, a strong/well known brand name will be of fundamental importance. However, the

consumer market will only become really interesting if or when, 'renewable energy' becomes more than just a moral issue or a green issue but develops into a viable and attractive financial proposition. Currently this is only true to a very limited extent.

There are however definite reasons to be optimistic. As a result of the anticipated increases in energy prices and the continuing improvement in technology, it will certainly become more financially attractive to invest in sustainable energy generation, which in turn will actually accelerate and fuel the transition. This is not only true when thinking about the generation of energy but also with respect to increased energy efficiencies and savings. In the immediate near future there is a huge opportunity to save energy, become more energy efficient and more energy conscious. This certainly represents a better investment in the short-term, rather than a direct investment in the development of sustainable energy generation. Some parties in the technical services sector now see that they have a key role to play in bringing innovative solutions to the market. In the future, they together with both the banks and energy corporations, will offer a total package solution that includes construction, financing, exploitation and maintenance, from which their customers can save energy and/or generate it themselves.



It also seems certain that there will be new players on the energy market. It is for instance obvious that internet and telecom companies can provide the (financial) settlement for locally generated energy. However, they may encounter unexpected problems caused by the way in which they operate. The energy business is fundamentally different from the IT business. Historically, the energy business operates from a long-term perspective, for example in the construction of reliable grids and plants, and with very high supply reliability. IT companies however, traditionally calculate with short payback times and usually will survive if a network is temporarily offline. The big winners will be the parties that can successfully bridge these (business culture) differences. Of course the energy companies themselves will not sit still but will invest in innovation. Many of the existing larger parties will choose to invest in and develop both new services and products, offered and produced by companies outside their own organisation (innovation incubators). By keeping them at arm's length in this way, they hope to avoid potentially smothering new ideas at birth with their existing corporate culture.

Capital is also a major factor in the successful transition to a new energy world. Currently, new models are being cautiously developed and tested in the market, such as those offered by the

Energy Service Companies (ESCO). ESCO companies finance of sustainable energy installations, potentially from specialised funds. At companies and consumers, who can rent these in exchange for a monthly fee. In essence, the idea is that the energy savings/generation that the installation produces will be shared between ESCO and the customer. This model is perfectly scalable and can be used either for the financing of large (industrial) facilities or by consumers to finance the installation of solar panels. However, this will probably be only a temporary model. When energy prices increase further, the pay back period of new facilities will continue to decrease and both companies and consumers alike will revert to the use of traditional forms of financing.

The largest single amount of capital required will probably be necessary for the construction of the smart grid. This intelligent energy grid will include charge points for electric cars, energy storage and financial settlement. The treasuries of many countries simply cannot afford the necessary billions in the aftermath of the recent financial crisis. Therefore collaboration between large market parties, financial institutions and the world's governments seems to be the only way to realise meaningful developments in this field. It is therefore essential that the government clearly defines the new energy market model

and provides a level of security to potential investors. Investors, including some large pension funds, will be willing to take (some) risks, if the government provides certainty on the rules of the market model and shows clear long-term commitment regarding the incentives and fiscal policy.

Finally, there probably will be democratisation of energy trading. The parallel here with the financial world is obvious. At the end of the twentieth century, due to the rapid and successful rise of inexpensive stock brokers, such as Alex, the general public gained access to the benefits of a professional capital manager. Something similar will probably happen on the energy exchange. Individual households and small to medium sized companies can generate energy and save money through a clever energy purchasing and sales strategy*.

* An adaptation of this vision has been published in an annex to the 'Financieel Dagblad' dated 9 June 2011.

Remaining still
and doing nothing
is probably the
worst choice



The energy sector is changing rapidly. New technology offers new possibilities for energy generation and savings; mergers and acquisitions contribute to a truly dynamic and fast moving (inter) national market; the competition is as fierce; global climate goals effect the strategies of the local energy sector; investment capital is difficult to obtain due to a combination of market insecurities and the prevailing economic head wind; and the liberalisation of the energy markets brings with it big challenges.

However, with such challenging times also come new opportunities and it is necessary to make clear choices. Sitting still, doing nothing and waiting to see what happens is probably the worst possible strategy. KPMG helps by understanding the developments in the market, charting the options and assisting in the decision making process. We can also assist in ensuring that organisations are both strategically and operationally prepared for the consequences of the choices they make.

Associated issues include:

4.1 Developing future-proof business models

When developing a clear vision of the future, a number of questions arise. What is our proposition to the market? What does the energy transition mean to our organisation? Do we become an energy producer or a marketing focused energy sales company or both? KPMG helps with the translation of that vision to concise business models and with the calculation and implementation of those business models. We go much deeper than just purely the financial side of the matter. We can also help with the set-up of the new organisation and the direction of the cultural component. Furthermore, information technology plays an important role in the transition to a new energy world. Our specialists advise organisations so that this information technology is developed future-proof and safe.



4.2 Financing

We use our experience and our network to achieve the required financing (equity, mezzanine and senior debt), of new or existing plans, including issues as diverse as investments in infrastructure projects or wind farms. The structuring of these finance questions is often extremely complex and requires an advisor with inside knowledge and a strong global network. Questions that require answers include; what is the exact financing need? This must be considered whilst evaluating a solid financial model which takes into account: capex, opex, off take contracts and the possibility to apply for subsidies, etc. How can this best be realised? Which parties need to be approached and what will their demands and wishes be? This requires an independent financial advisor, one that brings together relevant (market) knowledge, the right parties and is capable of securing the financing within the given time frame.

4.3 Advising on transactions

The market for renewable energy provides entrepreneurs with many opportunities to develop new plans and although there remains a strong economic head wind and tight capital markets, it is possible to find funding for the realisation of good ideas.

Developing new opportunities can also be achieved through collaboration with a strategic partner, in either a temporary consortium or permanently through a merger or take-over. In such cases it is necessary to focus on synergy, whilst at the same time ensuring that the risks are understood and managed adequately. Here we can help from the very first orientation and the drafting of a new business model, to closing and completing the final transaction. We will gladly use our strong global network.

4.4 Efficient management

Aggressive competition requires that companies active in the energy sector to put operational excellence first. This is more than just the temporary gains of cutting costs and trimming the budget. It is primarily focused on creating an operating model that delivers the maximum, in terms of both flexibility and efficiency. Furthermore, it also regards good working capital management. KPMG is expert in dealing with such questions. Based on proven benchmarks, we provide accurate insight into which processes can be improved and how. We aim to achieve structural improvements using for example IT, outsourcing and shared service centres.

4 KPMG helps energy companies to anticipate and predict the future

For more information regarding this publication you can contact Bas Huisman, marketing advisor at KPMG, huisman.bas@kpmg.nl



Green Power 2011: The KPMG renewable energy M&A report

Powering Ahead is the 2010 version of an annual publication which discusses trends in M&A in the Renewable Energy Sector. Over 500 senior executives were surveyed and supplementary interviews were carried out with key industry players to uncover the trends and outlook for the future.



China's Energy Sector: a Clearer View

This report shares KPMG's observations in China on key trends in each area of the energy sector, from up-stream oil and gas to power generation.



The ENR Finance Survey – Insights from Leading Finance Functions

Based on a survey of leading mining and upstream power and utilities organisations, providing insight and views on the latest trends, priorities and challenges for finance, including their response to the current economic turbulence.



Offshore wind in Europe

KPMG's report 'Offshore Wind in Europe – 2010 Market Report' in cooperation with the German Offshore Wind Energy Foundation 'Stiftung Offshore-Windenergie' concludes that the growth targets for offshore wind are at risk due to low returns.



Central & Eastern Hydro Power Outlook

Hydro power offers extremely varying potentials in the CEE region but provides a decent 23 percent share overall in the capacity mix of the region, placing it far above all renewable technologies.



Accounting for Carbon

Discusses the impact of carbon trading on financial statements; providing insights and strategies to help organisations understand and manage the business implications of climate change.

5 Other KPMG publications



Securing Investment in Nuclear in the Context of Low-Carbon Generation

The UK Government has set ambitious targets to reduce greenhouse gas emissions by 2050, and established Carbon Budgets up to 2022. The targets will require substantial investment in electricity generation with low emissions; nuclear, renewables and fossil fuel generation with carbon capture and storage (CCS). This report focuses on market and other mechanisms that affect the revenues for new nuclear investors.



The Future of the UK's Energy and Water Industries

Energy and water industry executives are increasingly questioning whether the existing utility business model remains fit for purpose. The survey of 320 executives reveals an enthusiasm for reform, calling for a more sophisticated shape for both the UK's energy and water markets.



Delivering Water Infrastructure using Private Finance

This whitepaper examines the risks and rewards of water PPPs and discusses how municipal governments and potential investors can benefit.





Construction Risk in New Nuclear Power Projects - Eyes Wide Open

Global pressure to reduce carbon footprint has led to a renewed focus on the power industry, with some estimates putting total global energy infrastructure investment at US\$26 trillion leading up to 2030. For energy specialists, there are high expectations for nuclear power generation as the lowest cost source of low-carbon electricity that can be delivered at the scale needed to meet this growing demand.



Taxes and Incentives for Renewable Energy (2010)

Governments have allocated more than \$430 billion in fiscal stimulus to key climate change investment themes, with China and the United States leading the way. This guide from KPMG International outlines the investment and operating support schemes available in 18 countries. The guide was designed to give a high-level overview of the various types of renewable energy incentives that may be available.



Alternative Energy Project Development - Update

This publication provides an update on alternative energy project development. Specifically, this publication discusses the Department of Energy (DOE) Loan Guarantee Program for renewable energy projects and the Federal Renewable Energy Program, focusing on the construction commencement requirements.

The KPMG Global Energy & Natural Resources (ENR) Practice

The KPMG Global Energy & Natural Resources (ENR) Practice is dedicated to assisting all organizations operating in the Oil & Gas, Power & Utilities, Mining and Forestry industries in dealing with industry trends and business issues. We believe we have a distinct portfolio of service offerings which have been carefully tailored to the needs of our clients, and can be delivered by our industry professionals. We have a well

balanced portfolio of clients, ranging from global super-majors to next generation leaders including those raising capital, some for the first time, in local markets.

The M&A Energy and Utilities team at KPMG is a leading global network of transaction professionals that regularly advises on some of the largest deals in the sector. The team provides strategic, financial and commercial advice on all types of transactions including acquisitions, disposals, fund raisings and capital market offerings.

About the KPMG Global Energy Institute (GEI)

The KPMG Global Energy Institute has been established to provide an open forum where industry financial executives can share knowledge, gain insights, and access thought leadership about key industry issues and emerging trends.

Energy Companies' financial, tax, risk, and legal executives will find the GEI and its Web-based portal to be a valuable resource for insight on emerging trends. To register for your complimentary membership in the KPMG Global Energy Institute, please visit www.kpmgglobalenergyinstitute.com

6 About KPMG

Contact Us

Hans Bongartz

**Partner and sector leader
Energy & Natural Resources**

T: +31 (0)10 453 4466

E: bongartz.hans@kpmg.nl

Gert-Jan Antvelink

**Partner Strategic Commercial
Intelligence**

T: +31 (0)20 656 4664

E: antvelink.gert-jan@kpmg.nl

Jaap van Roekel

Partner Transaction & Restructuring

T: +31 (0)20 656 7623

E: vanroekel.jaap@kpmg.nl

www.kpmg.com

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