Unfounded allegations on DONG Energy's share programme

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n the documentary by Danmarks Radio (Danish Broadcasting Corporation) on DONG Energy's capital increase, which will be broadcasted tonight, Wednesday 20 August at 20.00, it is claimed that DONG Energy's management should have a specific financial interest in the price paid by Goldman Sachs, ATP and PFA for shares in DONG Energy being as low as possible in order to obtain the most attractive ncentive programme as possible for the management. In the documentary it is claimed that DONG Energy's management had a dual role and thus being in a conflict of interest. It is further claimed that the ncentive programme would create lucrative conditions for DONG Energy's employees.

"The insinuations against DONG Energy's management and employees are severe and entirely unfounded. In reality, they imply that DONG Energy's management should have acted against the interests of the shareholders and Board of Directors to obtain a personal financial profit. can dismiss that entirely", says DONG Energy's CEO Henrik Poulsen and continues:

"Such assumption would require that the existing shareholders and the Board of Directors accepted that the management acted disloyally towards them and did not meet its contractual obligation. It is very difficult to understand why shareholders and the Board of Directors should accept this and it is obviously not the case. Also, it would require that the management was in a position to ensure a certain share price against the interests of the state and Board of Directors. Obviously, this was not the case. The price was a matter between the Board of Directors and the existing shareholders on the one side and the new investors on the other side. In this case it was the Danish state as majority shareholder who negotiated the price on behalf of the existing shareholders. This price was fully aligned with the market-based valuation of European energy companies."

The adoption of a share programme was requested by the Ministry of Finance and the new investors to secure knowledge and competencies in the company towards an IPO. It is an incentive and retention programme which in no ways is more attractive than similar programmes in other large Danish companies. On the contrary, DONG Energy's management and employees have to take on a more direct financial risk than what is typical for such programmes. The framework of the share programme is based on a cooperation between DONG Energy and the Ministry of Finance and the new investors have subsequently approved the programme.

"It is not at all unusual to implement a share programme in association with a capital increase such as this. In fact, you could ask if there any examples at all of a capital increase where new investors have paid a double-digit number of billions without having an incentive and retention programme implemented", says Henrik Poulsen.

It applies for managers as well as other employees that they invest in the company with their own money and are personally liable, with the opportunity to get a share in a possible future value creation. The share programme includes a bonus element which is redeemed if DONG Energy creates good results in the next years compared to other European energy companies. If an employee resigns prior to the IPO, which is expected to be implemented within 3-5 years, he or she is not entitled to receive a bonus.

With this programme management as well as employees have had the opportunity to invest in DONG Energy. In total 3,078 employees and 212 managers have chosen to buy shares for a total value of 222 million DKK. It was possible to buy shares for a total of 450 million DKK.

No foundation for allegation of higher value

In the documentary some critics repeat the allegation that the new investors paid a price too low for their shares and that the value of DONG Energy in reality was higher.

However, there is no factual basis for the allegation that the value of DONG Energy should have been higher than the price of 31.5 billon DKK which was the valuation of the company's equity capital at the time of the capital increase.

It is correct that the value of the equity capital in DONG Energy at the time of the IPO preparation in 2008 was assessed at 50-55 billion DKK. Since then the European energy sector has decreased with 50% in value as a consequence of a number of structural changes in the European energy market which also has affected DONG Energy. Consequently, it is not surprising that DONG Energy's value was reduced with about 40% during this period.

If one looks at the valuation in relation to the total value of the company including debt liabilities and compare it to the improved profit in 2013, the often used key figure (EV/EBITDA) equals a multiple of about 6.2, which is equivalent to the prices similar businesses traded at when the transaction was concluded.
In this case one have to take into consideration that the oil and gas business, which in DONG Energy's case constitutes the greatest part of the profit, traded at multiples at 3-4. In relation to the specific situation there were conditions which increased the price in relation to a comparison with listed companies, primarily the investors' so called put option at 60% of the investment, while other circumstances had a negative effect, including not least the insufficient liquidity of the shares, the size of the investment and the fact that the investment is a minority stake with the Danish state as the majority shareholder.

"It is pointed out by many that DONG Energy has a great potential. I fully agree. However, what many fail to notice is that the company also operates with a considerable risk. When you assess the value of DONG Energy you must look at potential as well as risks. Like other energy companies DONG Energy has substantial market-related, technological and regulatory risks", says Henrik Poulsen.

New equity capital essential
The reason for DONG Energy's capital increase was that the company suffered severe financial losses in 2012 due to challenges in the gas market combined with an increased debt for financing new investments. Together it meant that the company's credit rating was under pressu and in the autumn 2012 the rating agencies downgraded their credit rating of DONG Energy. If the credit rating should be restored an extensive restructuring of the company and a significant slowdown in investments would be required or, within a short time frame, to inject new equity capital.

The Board of Directors and the management assessed that such restructuring of the company and a significant and abrupt slowdown of investments would imply a major destruction of value in DONG Energy. Upon a thorough examination of the situation the Ministry of Finance reached the same conclusion and opted for a capital injection.

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