Eneti: The Merger Looks Good, But The Offshore Wind Market Does Not

Oct. 02, 2023 6:17 AM ET | **Eneti Inc. (NETI)** | CADLF | 4 Comments | 2 Likes

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About this article

Ticker	Analyst rating	Price at publication	Last price	Change since publication	S&P 500 change since publication
NETI	HOLD	**$10.02**	**$9.50**	**-5.19%**	**0.56%**

Summary

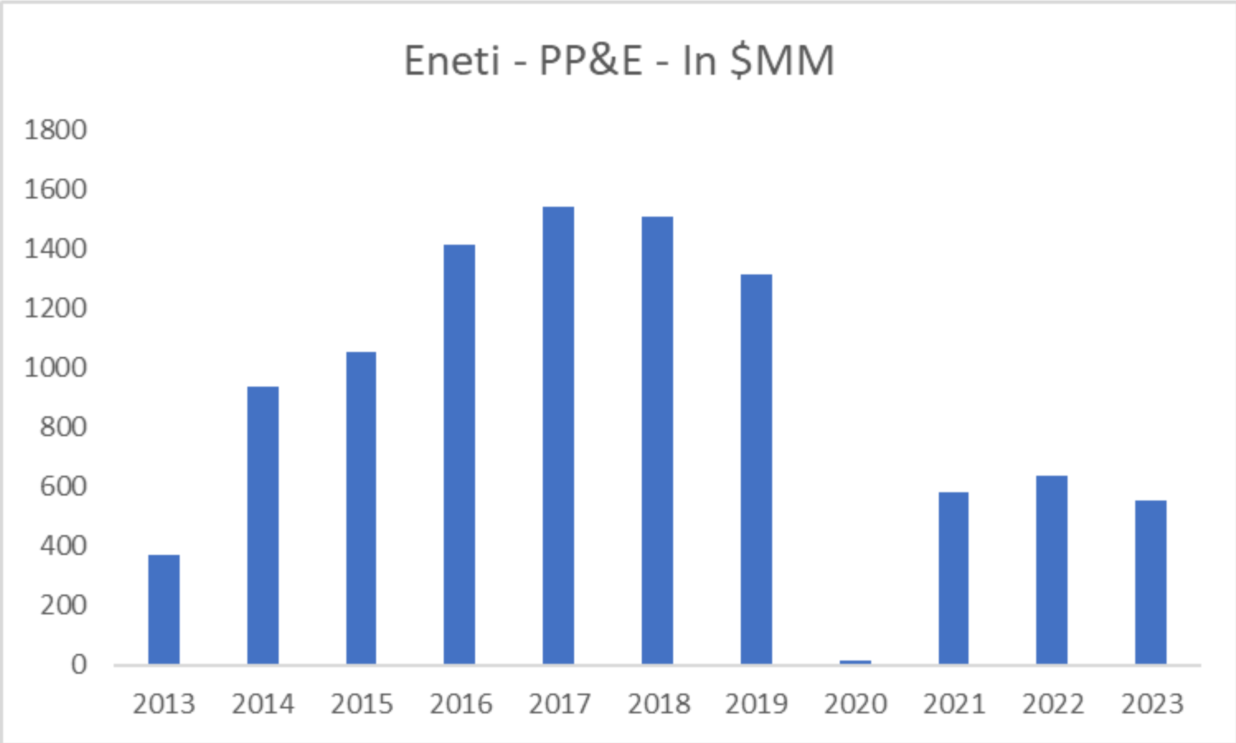
- Eneti plans to merge with Cadeler, a Copenhagen-based more established competitor. A transaction that would create a global leader.
- The offshore wind market is facing a cost crisis, with many operators canceling projects, which will negatively impact NETI's post-merger business.
- Concerns include the viability of planned projects due to rising costs, regulatory approval for the merger, and Eneti's significant Capex liabilities.
- We think that a fair price is around $11, and thus investors should simply take the merger payout of around $10.80 and cash out.

CharlieChesvick

Eneti (NYSE:NETI) announced back in June its intention to merge with Cadeler (OTCPK:CADLF), the Copenhagen-based shipping and construction company focused on offshore wind installations. It is a strategic transaction that will benefit both companies in the long run. However, we are concerned about the shape of the entire sector. Recent news highlights that the offshore wind market might be in a cost crisis, and many operators are canceling planned projects. This will of course act as a chronic and severe headwind for the post-merger business.

Eneti's business model and market overview

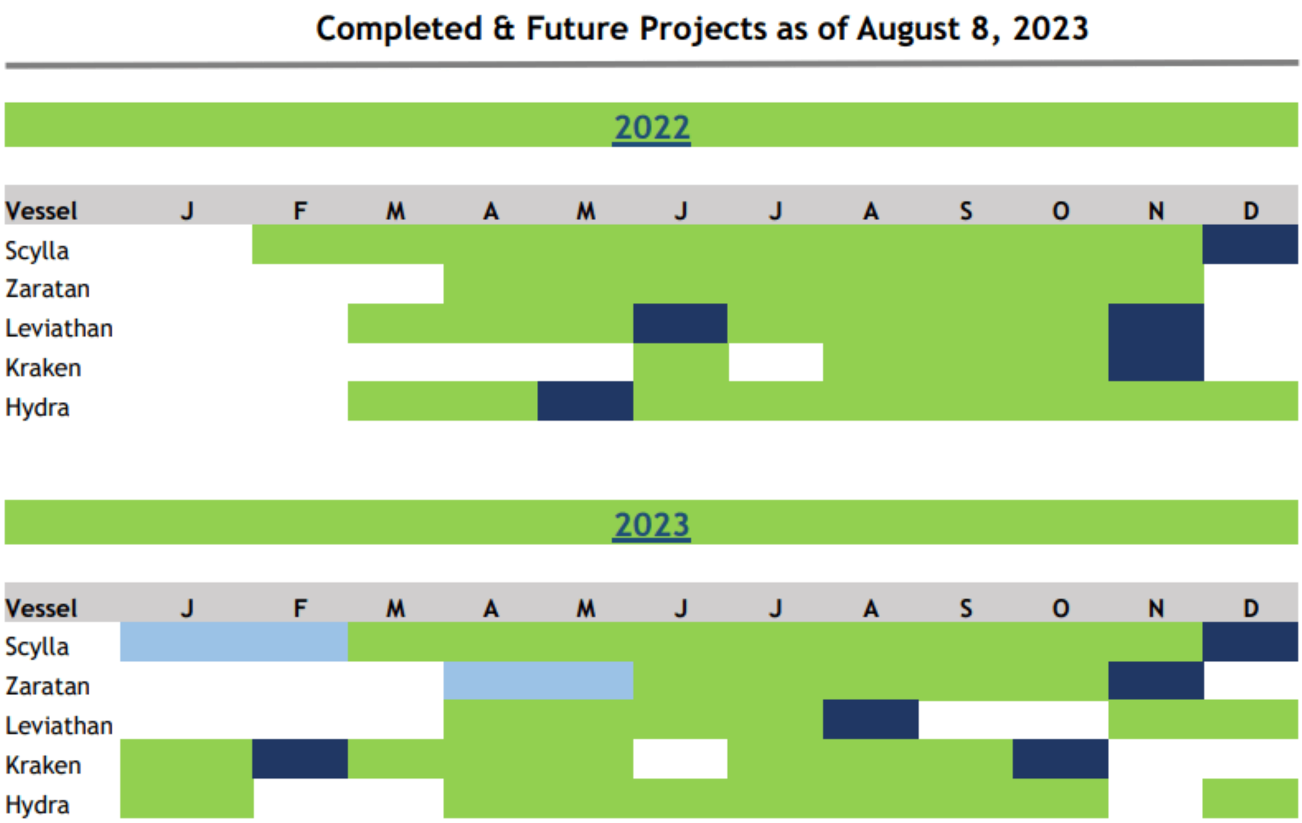
Eneti operates a fleet of 7 major vessels and a total of 14 that are used to build offshore wind farms across Europe. The company was previously an operator of dry bulk carriers, up to 2021, when they sold their entire fleet to move into the wind farm construction business. In the same year, they acquired Seajacks, an owner and operator of wind turbine installation vessels ("WTIVs").



Eneti - PP&E (Seeking Alpha)

The company is now engaged in this new business line, which of course has very different economics than the dry bulk operations. Indeed, revenues come from new offshore wind farm projects that require both construction and maintenance. The company charges a (daily) price for the usage of its fleet in these operations.

The business model is quite simple: the company makes money when vessels are used, and loses money when they are not used.



Vessels Utilization (Latest Presentation)

This shows that capacity utilization seems to be consistent with 2022 levels, which provided good financial results, although it is expected to slow in the second half of 2023. We are concerned about the current state of the wind offshore market conditions, and that these will negatively affect utilization rates of Eneti's fleet in the immediate future.

To give some perspective on the issue we highlight some headlines:

> The costs associated with U.S. offshore wind projects have risen by 57% since 2021 due to inflation in components and labor costs, as well as rising interest rates, leading to a large number of canceled or renegotiated deals.

And again:

> The recent cancellations of major offshore wind projects have erased billions of dollars in planned spending and put at least 9.7 additional gigawatts of offshore wind projects in the U.S. at risk

This mostly concerns the US, but as we know the cost crisis also impacted Europe and especially the UK. Indeed, the state of the wind offshore market in the UK is reported to be at a "tipping point".

The increase in costs is putting a lot of pressure on the actual viability of many of these planned projects, which may become economically unsustainable.

We also spot another considerable risk. As policymakers are continuously pressured on climate change targets, they may shift towards more stable and less expensive sources of energy, like nuclear. Germany is a great example of a country where this debate has become more and more relevant. Plans for a reopening of a plant were rumored in April, and the plans of future government coalitions may actually include the reopenings.

The Cadeler merger and Capex concerns

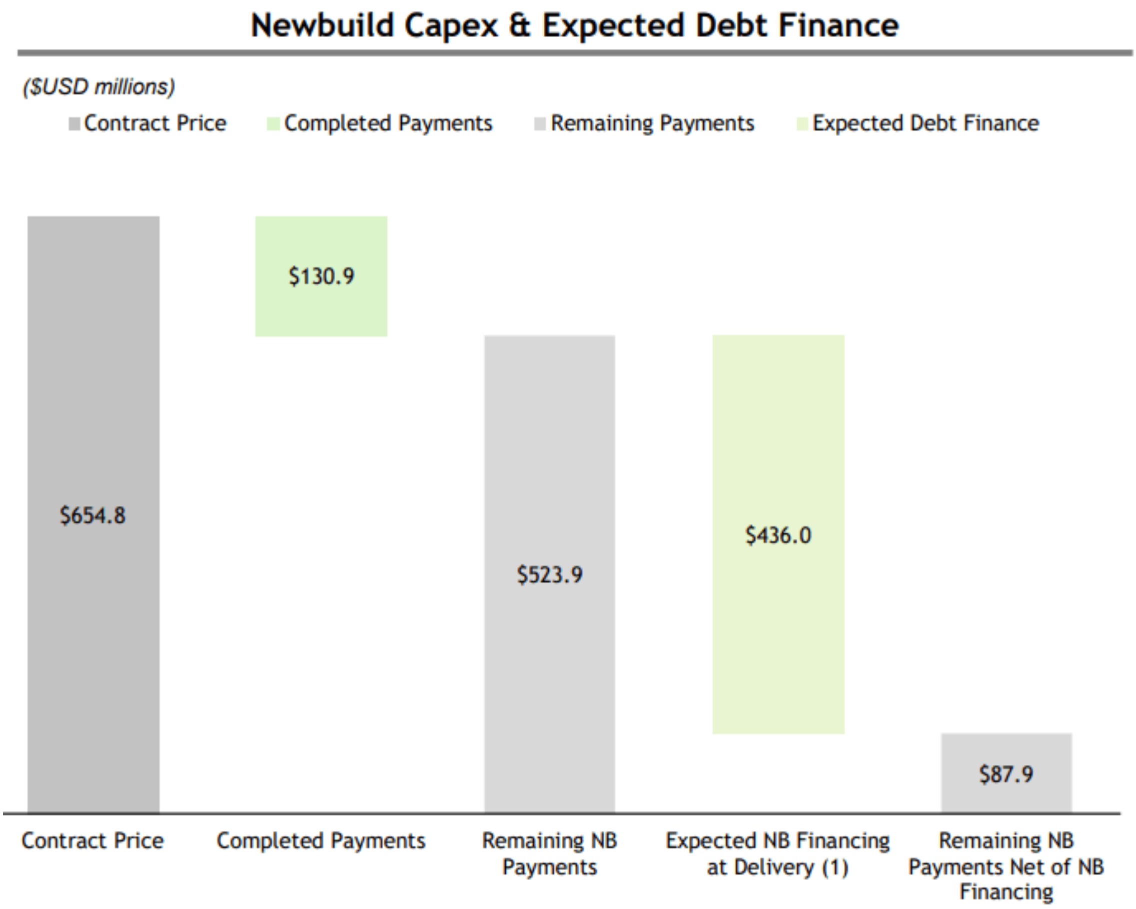
The big news regarding Eneti is the merger with Cadeler. In an all-stock transaction shareholders of Eneti are expected to retain 40% of the resulting entity. The exchange ratio is 3.409 shares of Cadeler for every share of Eneti, which at the current market price is around $10.9 per share, or $350 million.

Cadeler is one of the European leaders in the offshore wind market installations and maintenance, and the resulting entity would definitely have a strong market share allowing for good-looking synergies. However, we have two main points of concern:

1. Regulatory path for the deal, as UK regulators showed some degree of conservatorship in approving mergers and large acquisitions (see the recent Microsoft case blocked in the UK)
2. The big wave of binding Capex contracted by Eneti for the next years is inflexible and that does not account for demand/revenues growth profile

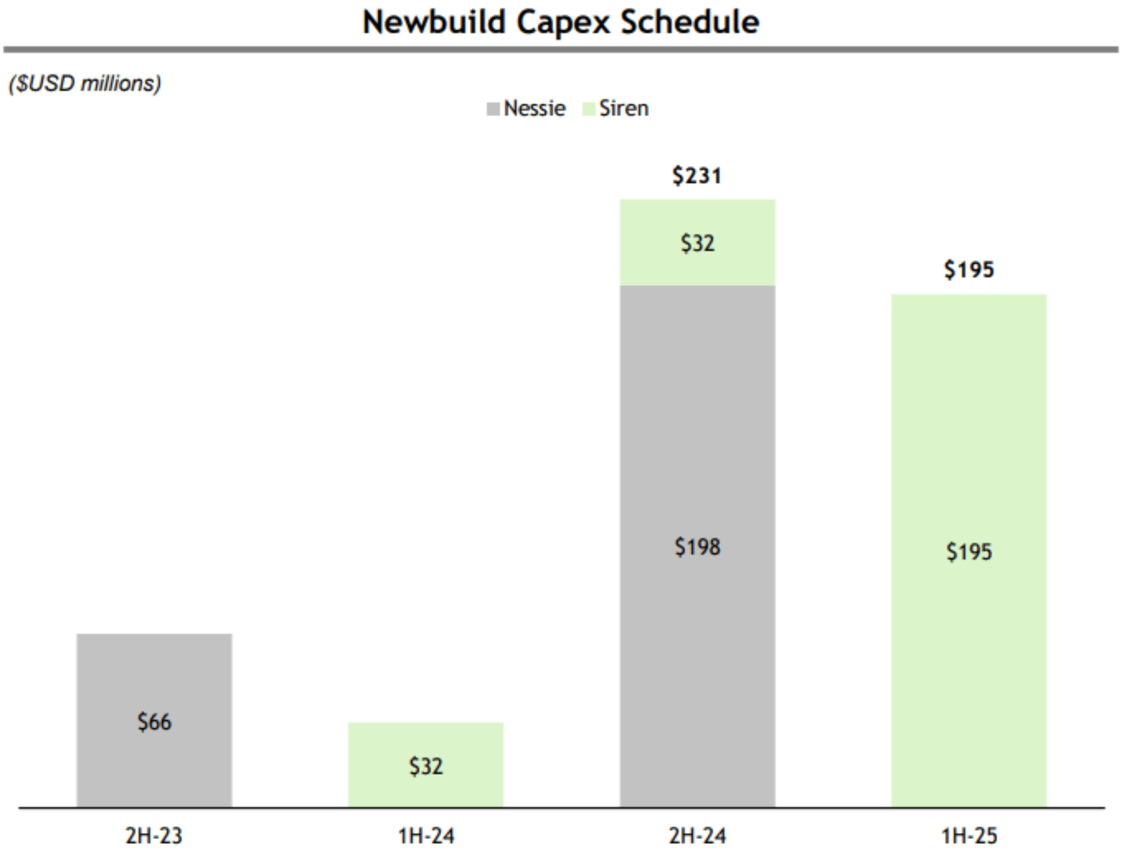
Regards the regulatory path, the deal watchers cited no concerns about potential approval. The market clearly agrees as the discount (i.e. merger arbitrage) is only 6-7%, very far from many other deals that underwent scrutiny. However, given the highly strategic importance of this sector, we cannot rule out entirely that some regulators (in every market where the companies operate) start paying more attention. This would of course weigh on Eneti stock more than Cadeler and is a not-zero risk.

Then there is Capex. This is clearly the unspoken elephant in the room. Because Eneti is very well-positioned in terms of liquidity and leverage profile. $120 million in cash against only $50 million of debt keeps the concerns away. However, they have some sort of "unaccounted" liabilities coming from the signed (and binding) contracts for the new fleet, which are in the range of $500-550 million in the next 2 years. Compared to the $60 million of FCF for FY2022, this is not a good sign if matched with concerns over demand and rising costs.



Capex and Financing Needs (Latest Presentation)

These are the projected costs and financing sources. As noted, Eneti expects to incur an additional $430 million of debt in the next years to finance these commitments. With a high cost of financing, this could get even uglier as the cost of debt might cut away a larger-than-expected share of the cash flows from shareholders.



Capex schedule (Latest Presentation)

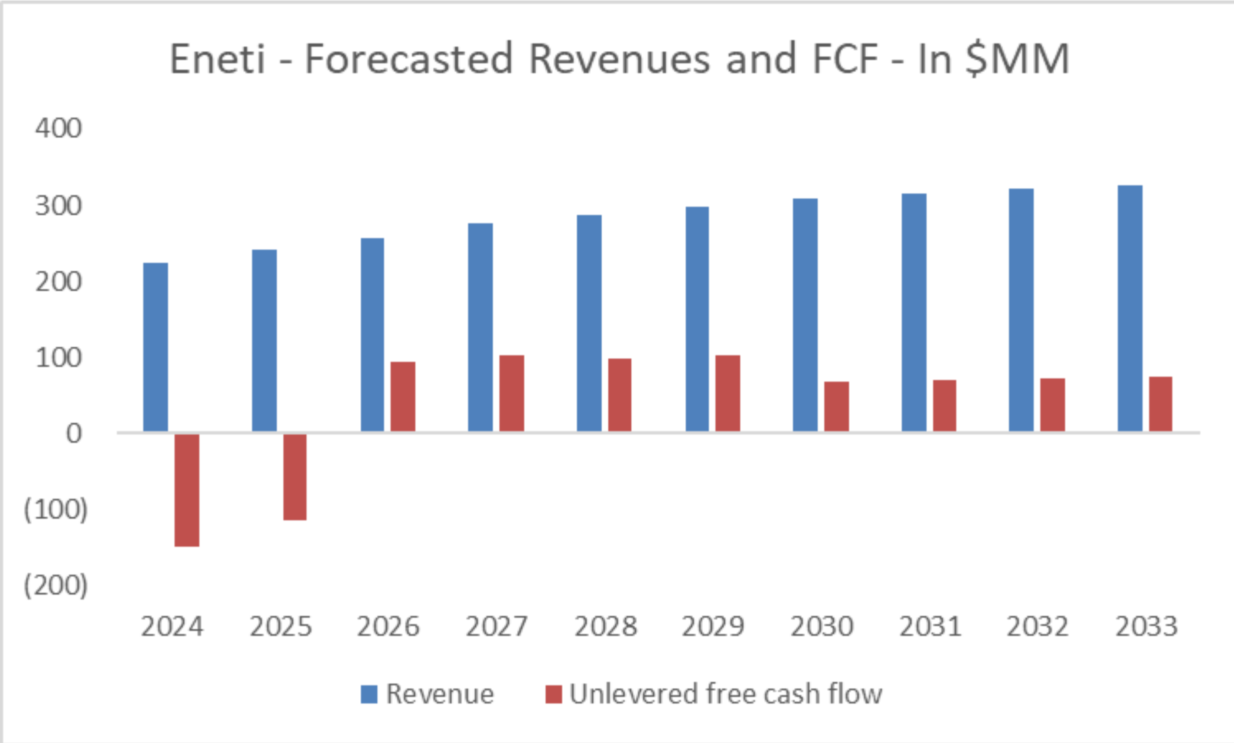
These are on the other end the expected "maturities" of the commitments. Most of them are in the second half of 2024, so there is some time for financing conditions to ease and improve the profile of the incoming debt. Still, there is clearly some risk mainly coming from movements in interest rates before then.

Evaluating Eneti: finding fair value in the merger

Since this is an all-stock deal, we feel that it is very important to still give a fair value range as shareholders might stick to the combined entity after the deal closes. We will however evaluate only Eneti's side of the transaction, and compare it with the deal consideration to be paid to see if it makes sense to stick to the post-merger company to unlock more value.

The assumptions behind our model are the following:

1. Revenue growth rate in the 5%-7% range for the next 5 years, to account both for lower demand now but sustained focus on renewables by policymakers in the upcoming years.
2. EBITDA margin of around 35% - 45% depending on stronger and weaker years. The company showed margins in the 40% range for FY2022.
3. WACC of 9% which is around the cost of equity. However, we think it would be very important to update this figure as soon as the pricing of the new debt to finance Capex is available.



Eneti - Forecasted FCF (Author's DCF)

This brings the total fair value per share to around $11, after of course accounting for the circa $500 million of additional expected Capex. If we compare this price to what is offered by Cadeler - around $10.80 - we notice that it is quite a fair consideration. Given that this is an all-stock transaction, we think that a fair move would be to simply liquidate the shares both pre or post-transaction at a level close to what is being offered today.

Conclusions

Eneti is an interesting company that underwent a major transformation that made it one of the key players in a niche market, and one of the few that is publicly listed. Now a more established competitor is seeking a merger, in an all-stock transaction valuing the company at $10.8 per share approximately.

However, we have various concerns, both systemic and idiosyncratic. The sector appears weak and facing significant headwinds that can negatively affect demand. Plus, there is a considerable liability coming up with the planned Capex for Eneti.

We conclude by saying that investors should simply take the deal and cash out, as the price offered by Cadeler is fair and square.

Editor's Note: This article discusses one or more securities that do not trade on a major U.S. exchange. Please be aware of the risks associated with these stocks.

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Joeri van der Sman 02 Oct. 2023, 7:15 AM

Premium **Investing Group** Comments (12.37K) | + Follow

Thanks for your article.

I agree offshore wind has had some major hiccups lately, but I also think this article is way too pessimistic. Hard to square that with this very positive recent press release.

Apparently a client is so worried about WTIV supply capacity that its willing to forward fix from 2027 onwards at a major rates step up…

Eneti Inc. Signs Vessel Reservation Contract for Newbuild WTIV

MONACO, Sept. 18, 2023 (GLOBE NEWSWIRE) -- Eneti Inc. (NYSE:NETI) (the “Company”) announced today that Seajacks UK Limited, a wholly-owned subsidiary of the Company and a leading provider of installation and maintenance vessels to the offshore wind sector, has signed a vessel reservation agreement with an undisclosed client to transport and install turbines.

With mobilization commencing in the first quarter of 2027, the contract will be performed by one of the Company’s two NG16000X Wind Turbine Installation Vessels currently under construction at Hanwa Ocean in South Korea. Inclusive of mobilization and demobilization, the engagement is expected to be between 210 and 245 days and generate approximately USD 87 million to USD 100 million of gross revenue. Project costs are expected to be USD 15 million in aggregate.

Emanuele Lauro, CEO of Eneti, says, “Through the ability to employ either of our two newbuilds, this project provides both maximum flexibility and accretive future cash flows. With net revenues approaching $350,000 per day, the contract reflects the improving fundamentals of offshore wind and current market conditions.”

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Joeri van der Sman 02 Oct. 2023, 7:52 AM

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"The big news regarding Eneti is the merger with Cadeler. In an all-stock transaction shareholders of Eneti are expected to retain 40% of the resulting entity. The exchange ratio is 3.409 shares of Cadeler for every share of Eneti, which at the current market price is around $10.9 per share, or $350 million."

With USDNOK at 10.74 and Cadeler trading 36NOK right now, I'm getting 11.43$ NETI bid. Not sure how you got 10.9$, hasn't been that low so likely an error in your calculation.

Another issue I have with this article is that it is looking at backwards looking earnings/cash flows. Both Eneti and Cadeler have major projects coming up, especially NETI with the 2 newbuilds. Cashflows and profitability will skyrocket up ofc with these.

I also don't see any problem financing the newbuilds, especially if the merger goes through. Cadeler is a BW Group company with great acces to finance. I don't think financing these is a problem for NETI on its own, but together with Cadeler its very easy to do.

Reply Like (2)

SMRT 07 Oct. 2023, 3:18 PM

Investing Group Comments (749) | + Follow

@Joeri van der Sman which one of the two is the most atractive at the present time, Cadeler or Eneti?

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Joeri van der Sman Yesterday, 12:59 PM

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@SMRT very easy calculation, Just look up the exchange ratio and the USDNOK exchange rate.

NETI trades at a large discount.

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