EVALUESERVE

M&A in Power & Utility sector – YTD Sep 2023

Corporate and Investment Banking Practice

December 2023

Impact of global events on P&U industry

The dynamic P&U landscape in YTD Sep 2023 presented a mix of challenges and opportunities. Disturbances, such as the war in Ukraine and supply chain disruptions, increased financing costs, while advancements, such as the EU's energy independence, opened doors to new deal opportunities.

Geopolitical factors

The war in Ukraine and the US-China trade war were the two most prominent geopolitical factors that affected the industry. The war in Ukraine caused significant disruptions to the global energy market and raised concerns about energy security in Europe. On the other hand, the US-China trade war disrupted supply chains for renewable energy technologies and made it more difficult and expensive for power utility companies to invest in clean energy projects. The above factors resulted in the increase of global energy prices by 20% in Q3 2023.

Energy independence

The European Union (EU) is pushing to reduce its reliance on imported energy, especially from Russia, resulting in increased investment in renewable energy. The EU aims to get 32% of its energy from renewable sources by 2030 and has also implemented various policies to encourage investment, such as feed-in tariffs and tax breaks. These policies have helped to make renewable energy more competitive with fossil fuels in Europe.

Digitization

Due to high demand, distributors and transmission system operators are investing in new smart grids and modernizing aging infrastructure. According to International Energy Agency (IEA), governments have allocated ~USD 20 billion for transmission and distribution system spending since the beginning of the pandemic until 2023. To achieve net-zero emissions by 2050, investment in smart grids requires a significant increase. It is anticipated that this investment will need to surpass USD 600 billion by 2030, more than doubling the current levels.

Clean energy investment

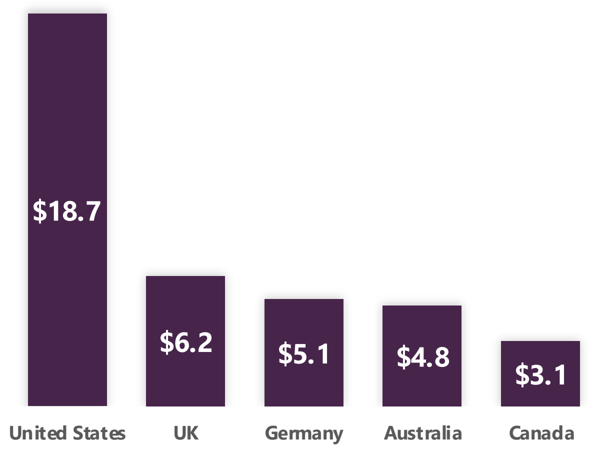
The US Inflation Reduction Act (IRA) is driving investment in clean energy, according to a report by Goldman Sachs Asset Management (GSAM). The report found that the IRA, signed into law by President Joe Biden in August 2022, has significantly increased investment in renewable energy projects, energy efficiency measures, and the development of new clean energy technologies. GSAM estimates that the government will invest USD 369 billion in clean energy through IRA in the next decade.

Source: Press releases

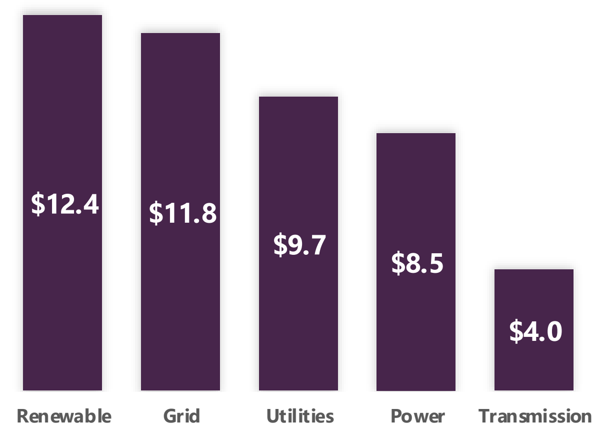
M&A activity in P&U industry

M&A activity in the P&U industry held its ground during Q3 2023, with 545 deals totaling USD 56.0 billion. This marks a modest 6% decline in deal volume compared to Q3 2022 and a 21% decrease in deal value.

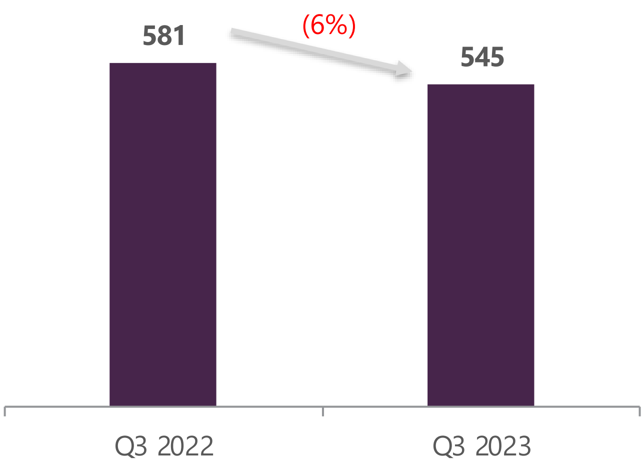
The top 5 countries by deal value in Q3 2023
$ in billion



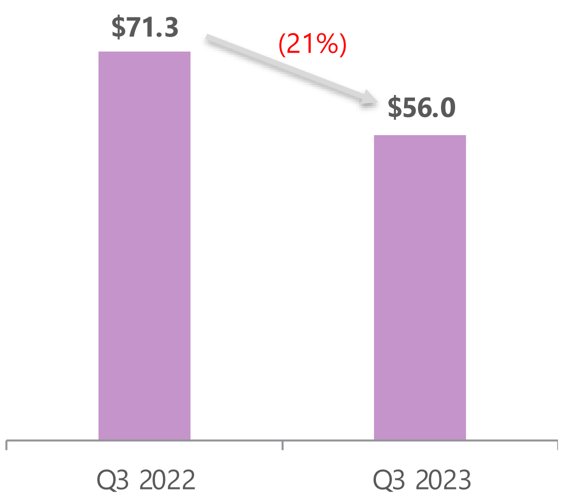
Deal value by subsectors in Q3 2023
$ in billion



Y-o-Y change in global deal volume



Y-o-Y change in global deal value
$ in billion



Source: Power Technologies and Global data

Top announced M&A by transaction value (YTD 2023)

Date	Target	Target's advisor	Transaction value (USD billion)	Acquirer	Acquirer's advisor
6-Nov-23	Statera Energy	Macquarie Capital	0.6	EQT Infrastructure	DC Advisory
3-Nov-23	Morrow Renewables	NA	1.2	Enbridge	JP Morgan Chase & Co
26-Sep-23	Florida City Gas	Goldman Sachs	1.0	Chesapeake Utilities Corporation	Barclays
5-Sep-23	Dominion natural gas distribution companies	Citigroup and Goldman Sachs	14.0	Enbridge	Morgan Stanley and RBC Capital
28-Aug-23	STEAG	Morgan Stanley	2.8	Asterion Industrial Partners	Ernst and Young
24-Jul-23	London Array	NA	0.9	Schroders Greencoat	NA
11-Jul-23	TransAlta Renewables	National Bank Financial Inc and TD Securities Inc	1.0	TransAlta	RBC Dominion Securities Inc
12-Jun-23	Iberdrola Mexico	JP Morgan	6.0	Mexico Infrastructure Partners	Barclays
12-Jun-23	Commercial Renewables (Duke Energy)	NA	1.1	Brookfield Renewable	Scotiabank, BMO Capital Markets, TD Securities, and CIBC Capital Markets
26-Apr-23	Total Energies EP Canada	NA	4.5	Suncor Energy	JP Morgan Securities Canada

Source: Company press releases & Global data

Key trends and drivers of P&U industry

M&A in the P&U industry is anticipated to be impacted by numerous factors, including the energy transition, technological advancements, investor interests, and regulatory policies. Some of the key trends include the following:

ESG and sustainable investments

According to PwC's projections, asset managers worldwide will increase their ESG-related AuM to USD 33.9 trillion by 2026. ESG-influenced investment and M&A activities have been gaining prominence, i.e., the big players are acquiring new clean energy players. Key M&A activities include Ørsted's acquisition of Lincoln Clean Energy, Iberdrola's acquisition of UIL Holding, and E.ON's acquisition of Innogy.

Mobility electrification

The global electric mobility market will likely post a CAGR of 14.6% from $109.2 billion in 2022 to reach USD 325.6 billion in 2030. It is expected that 50% of new light vehicles sold in Europe will be electric vehicles by 2030. The rising EV adoption will drive demand for charging infrastructure and trigger M&A activities in the power sector. Notable M&A examples include Shell's acquisition of New Motion, Enel's acquisition of eMotorWerks and Total's acquisition of Saft.

Repositioning of portfolio toward energy transition

The International Energy Agency (IEA) expects that renewables will account for 47% of the global electricity market by 2040 vs. 29% today. Businesses are using M&A as a strategy to accelerate their portfolio transformations. They are investing in the energy transition while simultaneously divesting high-carbon assets. M&A activities are influenced by the sensitivity of big players in the industry toward carbon neutrality. A few key examples are Total's acquisition of SunPower, Engie's acquisition of Renvico, and Brookfield's acquisition of TerraForm.

Technology advancements

The sector is undergoing a technological transformation due to the adoption of AI, IoT, and blockchain. These technologies will support companies with predictive maintenance, demand forecasting, and grid optimization. To leverage these benefits, P&U companies seek opportunities with players from the sector. For instance, American Electric Power acquired Enlighted, an IoT solutions provider.

Smart meters and smart grids

Globally, businesses are prioritizing the development and integration of smart meters and smart grids. Global System for Mobile Communications Association estimates North America will host 1.4 billion smart buildings by 2030. The M&A space is experiencing the impact of this shift. For instance, in January 2023, Badger Meter announced the acquisition of Syrinix, a provider of intelligent water monitoring solutions.

Source: Company press releases

Effects of rate base on M&A activities in P&U industry

The rate base serves as a key metric for evaluating the financial viability, regulatory implications, growth prospects, and potential synergies in M&A transactions within the P&U industry. As per the data tracked by Regulatory Research Associates, investor-owned utilities in the US asked for rate hikes of USD 17.2 billion in 2023, up by 2% compared with 2022. The rate base has a notable effect on M&A activities in the P&U industry. A few examples of rate base's influence on M&A activities are as follows:

Increased financial stability and synergy potential

A high-rate base signifies a large asset base, boosting financial stability. M&A activities target aim to achieve operational synergies and cost savings. Combining rate bases yields economies of scale and better efficiency. For example, in 2020, NextEra Energy acquired Gulf Power for its substantial rate base and stable cash flows. In 2016, Exelon Corporation acquired Pepco Holdings, an electric utility company serving the mid-Atlantic region, for USD 26.2 billion to enhance scale and operational efficiencies through rate base consolidation.

Regulatory considerations

M&A transactions in the P&U industry often require regulatory approvals, and regulators consider the rate base during the review process. For instance, Avangrid acquired PPL Corporation for USD 29.1 billion in 2022. The acquisition was subject to review by the Pennsylvania Public Utility Commission (PUC) and the Federal Energy Regulatory Commission (FERC). The PUC expressed concerns about the potential impact on customer rates and the ability of the combined entity to maintain a reliable and affordable electricity supply.

Growth opportunities

Acquiring a company with a significant rate base can provide growth opportunities for the acquirer. By expanding their rate base, utility companies can potentially increase their customer base and revenue. In 2022, Brookfield Infrastructure Partners acquired UGI Corporation for USD 11.4 billion. The acquisition expanded Brookfield's portfolio of regulated utilities and increased its exposure to the natural gas market.

Source: Company press releases

Outlook for P&U industry

Utility companies will continue facing a downturn in both renewable and traditional energy infrastructure, as observed historically. Regulatory rules coupled with mounting inflation pressure will pose challenges to project economics, particularly in offshore wind. To overcome challenges faced in 2022 and 2023, P&U companies will likely take a cautious and rigorous approach to project development efforts in 2024. Further, the P&U industry outlook for some renewable energy investments is expected to remain attractive over the next few years due to the existing policy incentives across different regions globally.

USA

Continue to be broadly challenged by macroeconomic and geopolitical pressures

The positive impact of US IRA passage and ESG focus is expected to create investment opportunities in key asset classes for the rest of 2023. Deal volume and value are currently below the five-year average, but a resurgence is anticipated for the remainder of 2023 and 2024. In the upcoming year, IRA momentum, ESG initiatives, investor interests, portfolio realignment, and strategic focus are anticipated to drive investment prioritization and deal activity in the P&U sector.

EMEA

More selective in 2024 due to inflation and higher cost of materials

In 2024, the top 40 European utility companies will invest a capex of EUR 132 billion, up by 5% y-o-y compared with EUR 126 billion in 2023. Like in 2023, investments by European integrated utility companies will be concentrated 70% in Europe and the remaining 30% outside Europe in 2024. Spanish, Portuguese, and Italian integrated utilities are committing up to 60% of their total investments outside the European market due to strong growth potential for renewable energy demand and grid services in these regions. The anticipated surge in investments by network utilities, which is projected to surpass EBITDA by 30% during 2023–24, could also fuel M&A activities.

APAC

Asia-Pacific to power global offshore wind growth

Volumes for APAC utilities will expand by 4–5% during 2024–25, amid resilient economic growth in the region. Given fossil fuels still dominate the region's overall energy consumption, softening fuel costs can help protect cash flows. However, the trend could change if geopolitical risks further escalate. Nearly half of the planned 380MW global offshore wind capacity will come from APAC by 2032, according to the Global Wind Energy Council. This surge in offshore wind development will likely fuel M&A activities in the industry as companies seek to expand their offshore wind portfolios.

Conclusion

M&A activities in the P&U industry will remain subdued over the remainder of 2023, due to continued regulatory and consumer uncertainty. Large utilities will continue focusing on repositioning their businesses towards energy security, decarbonization, and energy transition-aligned themes. Furthermore, it is expected that greater focus will be on portfolio optimization and rationalization strategies by P&U companies to improve their balance sheets and reinvest capital into crucial strategic priorities. However, the high interest-rate environment may lead to restructuring and the potential for distressed M&A, with market conditions favoring larger utility companies that will be well positioned to acquire more levered or financially constrained competitors.

Source: Company press releases

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