

M&A
EUROPE

Europe energy and infrastructure M&A: risks and opportunities in 2024

While headwinds such as high interest rates continue to affect dealmaking, changes in regulatory policies on nuclear energy, FDI and the North Sea bring both risks and opportunities for investors



Rising interest rates and stubbornly high inflation contributed to a subdued deals market in 2023. There was, however, no shortage of M&A highlights across the energy and infrastructure sectors, including the year's two largest transactions. If interest rates and inflation begin to stabilise as expected in 2024, we anticipate that investors will be particularly attracted to the opportunities presented by the continued push towards renewables and net zero in European economies. In this article, we explore such opportunities, and consider how a stabilising macro-economic environment and recent regulatory developments in the UK and EU could shape energy and infrastructure dealmaking in 2024.

Inflation and interest rate pressures re-emerge

Rising interest rates and higher inflation were key features of the M&A market in 2023, which ultimately led to continued value misalignment between buyers and sellers and a contraction in infrastructure deal volumes and values. While financial sponsors have become somewhat accustomed to higher rates and more expensive debt, the expected easing of inflationary pressures and the anticipated normalising of interest rates in 2024 should lead to a further closing of the valuation gap as sellers adjust their price expectations and improve their valuation accuracy to account for higher costs of capital.

An uptick in energy and infrastructure M&A activity (particularly for assets supporting the energy transition) is likely to be driven by the convergence in price expectations between parties and financial sponsors seeking to deploy pent-up dry powder that has accumulated during the M&A slow-down. For transactions where the valuation gap cannot be easily bridged, we expect to continue to see the use of bespoke contractual provisions by financial sponsors, such as earn-outs and contingent/deferred payments in addition to creative financing arrangements, such as the use of bid consortiums.

The ongoing threat of a prolonged conflict in the Middle East remains a significant risk to supply chains, as well as inflation and interest rate stabilisation in the near term. Recent attacks on merchant ships in the Red Sea have already caused the most significant disruption to global shipping since the COVID-19 pandemic and are expected to impact European supply chains in the next six to 12 months. While the price of crude oil and natural gas has (as at the date of publication of this article) remained relatively stable, the potential for substantial increases in shipping costs and further strains on energy and other supply chains caused by the escalation of the conflict in the Middle East threaten to counteract recent disinflationary forces and the convergence of price expectations between transacting parties.

Deal activity in the North Sea

Although 2023 heralded some of the most significant changes to the UK's energy regulatory framework in a decade – including the Energy Act 2023 receiving royal assent – we expect that regulatory uncertainty in the lead up to the 2024 UK general election will cause a further slowdown in North Sea oil and gas M&A activity. Several oil supermajors have in recent years divested or expressed an intention to offload ageing upstream oil and gas assets in the North Sea and instead focus on more cost-effective regions such as the North American shale. Despite the eagerness of the supermajors to divest or carve-out North Sea assets, deal activity will be impacted by

uncertainty as to how the North Sea regulatory framework will change after the UK general election.

On February 8 2024, the UK Labour Party announced its election commitment to increase the current 75% windfall tax on energy super profits to 78% and extend the lifetime of the windfall tax until the end of the next UK parliamentary term in 2029. Labour's announcement has been received by some in the industry as a continuation of "negative signalling" towards the North Sea's incumbent operators in the wake of Labour's earlier pledge to end oil and gas exploration in the basin. On the other hand, messaging from the incumbent UK government has been described as "mixed" in the wake of the government's significant expansion of oil and gas licensing rounds and refusal to consider changes to windfall tax arrangements. Ultimately, we anticipate that investor demand in the North Sea will remain subdued until such time as the UK government's regulatory framework in respect of the North Sea becomes more certain.

Resurgence of nuclear energy in Europe

In Europe, energy M&A activity will be underpinned by the resurgence of investor interest in nuclear energy in the wake of renewed backing for nuclear power by EU policymakers. 2023 saw a number of key developments in respect of nuclear power in the EU, including the European Commission agreeing to include existing nuclear plants in electricity market reforms, and "advanced technologies to produce energy from nuclear processes with minimal waste from the fuel cycle, small modular reactors, and related best-in-class fuels" being included as net-zero technologies in the EU's Net Zero Industry Act. The EU's recognition of nuclear as a source of low carbon energy is likely to draw renewed interest from investors across the nuclear energy supply chain. In particular, we expect to see investors targeting assets which support upgrades to existing nuclear facilities and plant life extensions, in addition to investment in entities that are developing new technologies such as small modular reactors.

Foreign direct investment and antitrust deal scrutiny

Intervention by regulators in M&A transactions on foreign direct investment and antitrust grounds increased to historically unprecedented levels last year, and we anticipate that heightened regulatory intervention in energy and infrastructure transactions will continue in 2024.

In Europe, the Foreign Subsidies Regulation (FSR) came into force in January 2023. The FSR empowers the European Commission to intervene in M&A transactions and requires buyers to notify the European Commission of transactions involving the acquisition of certain EU businesses (with at least €500 million in EU-wide turnover) which receive "financial contributions" from non-EU countries (which is broadly defined to include direct funding and grants, tax exemptions and contracts with public bodies). Although the scope of the FSR is subject to further clarification, it is conceivable that entities relying on government green energy subsidies in the UK or US will be subject to greater foreign direct investment scrutiny from the European Commission under the FSR.

In the UK, we expect increased regulatory scrutiny from the Competition and Markets Authority (CMA) on downstream energy networks. The Energy Act 2023 introduced a new merger control regime which enables the CMA to refer mergers between an energy network with a turnover of at least £70 million with another energy network holding the same licence to a CMA inquiry group for investigation.

Energy and infrastructure leading the M&A recovery

While we do not expect dealmaking activity to reach the levels seen in 2021, we would expect an uptick in energy and infrastructure M&A transactions in 2024 if economic conditions stabilise. Both sellers and buyers should familiarise themselves with the extensive regulatory changes brought about in 2023 which will inevitably shape dealmaking this year.

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