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2020 US & CANADA M&A OUTLOOK: RENEWABLES AND TELECOM WILL DRIVE DEALS AT A SMALLER CLIP

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The twin peaks of midstream and telecom will drive M&A again in 2020 but political election fears may keep spending in check, as Andrew Vitelli and Jon Berke report

USA & Canada

Sector: Energy
Power
Renewables
Social Infrastructure
Telecommunications
Transport
Other

Country: USA
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Despite concerns about the economy, the re-election of Justin Trudeau in Canada and next year's elections in the US, there is expected to be a host of M&A opportunities in North America midstream and telecoms. It just might come at a smaller clip then last year with increased capital markets activity as interest rates remain at a low ebb.

This could set up for an intriguing year amongst infrastructure funds, particularly as Brookfield Infrastructure Partners and Global Infrastructure Partners near USD 22bn closes, respectively, on both of their recent efforts when it comes time to deploy those funds. Meantime, veteran asset managers remain right behind them to raise their next generation of funds.

“Many attractive opportunities remain on a risk-return basis as buyers differentiate between higher quality and lower quality investments,” said Michael Ryder, senior managing director at OMERS Infrastructure Americas.

“For the bigger funds, it’s likely they will focus most of their attention on take privates as there are relatively few private assets that offer that kind of scale," said Andrew Clarehout, partner at Searchlight Capital Partners and former head of Infrastructure and Natural Resources at Ontario Teachers Plan.

For smaller funds, though, opportunities could await, particularly if the economy softens and valuations start to drop.

“It feels like we are at the latter stages of the current bull market,” added Ryder.

Midstream

Hanging over the energy sector is the 2020 presidential election. With Democratic presidential candidates promising ambitious proposals for decarbonization, some going as far as a ban on fracking, the outcome could have consequences felt across the industry.

“The sector is in a wait-and-see mode,” says Brian Baker, a managing partner and the chief investment officer of transport and energy in Brookfield’s infrastructure platform. “People are really curious about what the outcome of [the election] is going to be and what it is going to mean for energy and the sector’s ability to access capital.”

There were several mega-deals in the midstream space in 2019. Overall, there 24 deals which reached financial close in North America and Canada worth over USD 22bn as IFM Investors, Blackstone Infrastructure Partners and others invested in the space, according to *Inframation Deals.* Five other deals were executed this year, but no financial value was disclosed.

This trend was driven by the perception that these companies had been undervalued by the public markets, with private equity and infrastructure funds having a fairer valuation. This dislocation could continue to lead to further deals in 2020, Baker says. On the other hand, the increasing uncertainty around the election may give infra funds pause, while public companies and the owners of midstream assets will be wary of selling low.

“My expectation is more highly-contracted assets will be favored,” Baker says. “More acreage dedication, less contracted, less visibility cashflow assets could struggle.”

The political dynamic could shift by mid-Spring if a moderate candidate looks on track to win the Democratic presidential nomination.

Kevin Crews, a partner at the Dallas office of Kirkland & Ellis, expects a continuation of trends seen in the last 12 to 18 months in the energy infrastructure sector. A downtick in marquee privately held midstream companies being brought to market is possible, but he sees continued interest in unique and hard-to-recreate assets, specifically citing the water infrastructure space as an example.

Crews expects further consolidation in the industry, as “the MLP structure likely goes the way of the dodo Bird and publicly-traded midstream companies continue to wrestle with how to finance the build-out of crown jewel assets when capital markets aren’t always cooperating.”

"I expect M&A and, in particular, capital raise activity to stay strong, if not pick up, and I would expect deal value to be consistent with how it's been recently," Crews says.

In the renewable space, CohnReznick Capital managing director Britta von Oesen predicts an "extremely active M&A market" in renewables, like 2019, with continued consolidation of the industry taking place.

"There are a number of groups that are still looking to pick up platforms, whether it is expanding into other niche areas like [distributed generation] or storage or things like that," she says. "I think we continue to see medium to small-sized players get picked up by larger [independent power producers] and utilities."

More data to move

The North America telecommunications sector took off in 2019 led by a USD 14.3bn buyout of Zayo Group by a consortium of EQT, Digital Colony Partners and Devonshire Investors.

Investors expect this sector to stay active, though they see fewer mega-deals and more in the USD 250m-USD 500m equity check range.

"In the US, I think you will still continue to see infra funds investing into data centers and doing follow-ons into what they've been pursuing," says Jon Kelly, chief investment officer for utilities and data infrastructure for Brookfield's infrastructure group. "Maybe it will be a little bit less active on some of the very large-scale opportunities that were rumored in the market this past year."

Matt Evans, global head of communications infrastructure for AMP Capital, predicts "a little bit less M&A activity and a little bit more financing activity." He expects cloud platforms to be a target for infra funds.

"You will see more people like us starting to get more understanding of and more comfortable with those cloud platforms," says Evans. "At the end of the day, that is where a lot of money is going to be required."

Speed bumps ahead

The transportation space, where deal flow has already been lumpy, might see a further slowdown caused by macroeconomic uncertainty, investors say.

The potential for a recession is likely to lead to caution among investors, Baker says. Brexit and an uncertain trade situation between the US and China may make investors cautious to bid for GDP-driven assets, he adds.

Some infra funds might evaluate transportation-related companies such as logistics firms if traditional transportation assets do not materialize.

"We've seen a clear increase in the number of these opportunities coming to market," Baker says. "Now the question is, are you going to see a buyer group emerge that drives a lot of the transactions in those types of assets?"