Directions in Public M&A: FY19/FY20

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Introduction

Welcome to the sixth edition of MinterEllison's Directions in Public M&A report.

The recent trends and predictions for Australian public M&A activity profiled in this report reflect a perennial reality: regardless of economic and geopolitical conditions, companies will continue to pursue M&A activity in some shape or form. The drivers of M&A activity are diverse and often transcend prevailing market conditions. These drivers include a need to increase scale in the face of rapid industry consolidation, increased industry costs, shrinking margins and/or anaemic organic growth; a desire to reduce scale by streamlining a diversified business and focusing on its core activities (e.g. a demerger or trade sale of a non-core business unit); a desire to complement existing operations by pursuing a so-called bolt-on acquisition; taking opportunistic advantage of a competitor's market decline or financial distress; responding to competitive industry threats (e.g. by acquiring an emerging and innovative challenger); pursuing a transformational deal that will significantly increase the acquirer's geographic footprint and/or product and service offering. Overlaying all of these industry drivers is the formidable presence of private equity and superannuation fund investors, both of whom are increasingly important players in Australian public M&A activity.

Following more than two decades of sustained economic growth, Australia continues to be an appealing destination for inbound foreign investment. Despite the shadows of a potential economic slowdown, the ongoing stability and continuity of the Australian market for corporate control, reflected in this report, should provide confidence for international and domestic companies to continue to pursue M&A transactions.

While the Australian market offers stability and continuity, our regulatory landscape needs to be appropriately navigated. Although our regulators are generally facilitative of public M&A transactions, understanding their sensitivities and processes is critical. Equally, companies need to be nimble and creative with their deal structures and tactics to succeed, especially in the face of increased competition for attractive targets.

Our report reflects these themes, exploring the significant activity in public M&A in FY19, commenting on the regulatory landscape, identifying likely industry hotspots and outlining our predictions for the remainder of FY20

We look forward to continuing to support our clients with their public M&A strategy, as we navigate the opportunities and challenges our market presents.

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MinterEllison was pleased to have a central role advising on many of the M&A market shaping transactions profiled in this report.[1]

We trust that our report provides some interesting perspectives and a useful resource.

We're pleased to present our observations on public M&A trends in FY19 and our predictions for the remainder of FY20. These set off our analysis of ASX market data for the financial year ended 30 June 2019. Consistent with our approach in the past two financial years, we set our market data compilation threshold as announced deals with a value of $A50 million or more. For FY19, there were 45 announced deals that met this threshold, an increase of 25% on our sample size in FY18.

Public M&A activity on the whole substantially slowed in the second half of FY19, with only 17 of the deals in our sample being announced in the second half of FY19 (compared to 28 in the first half). This was likely the result of the federal election in May 2019 giving would-be acquirers cause to rethink and pause on potential acquisitions in the face of uncertainty about the policy and legislative environment going forward, as well as caretaker mode temporarily stopping foreign acquirers from obtaining FIRB approval.

Section 1
commences with a look at the statistics for FY19.

Section 2
sets out our observations on the key trends from the 45 deals in our FY19 sample.

Section 3
provides our insights on the roles played by the key Australian regulators (ASIC, the ACCC and FIRB) in shaping M&A activity.

Section 4
concludes with our outlook and predictions for the remainder of FY20, including sectors to watch.

[1] In FY19, MinterEllison had a role advising on each of the following announced corporate control transactions, either acting for a first bidder, counter-bidder, target or major shareholder: BWX, Gateway, Xenith IP, Healthscope, Amcor, Phileo, Capilano Honey, Legend Corporation, Creso Pharma

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Executive summary

FY19 – 'Steady as she goes' signals a comforting level of stability

At first glance, when looking at the statistics and trends from FY19 and comparing them to FY18, one could be forgiven for thinking that it's been much of the same – after all, the similarities between FY19 and FY18 are striking. For example, auctions for control of ASX listed targets remained prevalent in FY19; private equity continued to be a key driver of Australian public M&A activity; the mid-market remained the epicentre of M&A deal activity; foreign bidders continued to dominate; schemes remained the preferred structure for friendly deals; cash remained the preferred form of acquisition currency; and regulators such as ASIC, the ACCC and FIRB continued to exert considerable influence over deals. Likewise, the prospect of an announced deal being disrupted by shareholder activism continued into FY19.

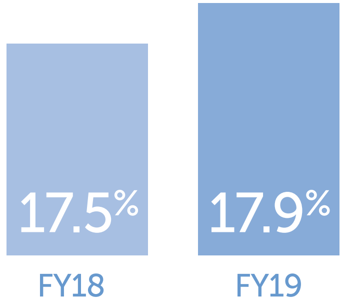
Rather than bemoaning any dramatic changes between FY19 and FY18, we see this consistency in the statistics and trends over the past two financial years as a positive sign. It demonstrates stability and continuity in the Australian market for corporate control. This predictability can provide a level of comfort and assurance within which companies feel confident transacting.

If one scratches a little deeper beneath the surface of these similarities between FY19 and FY18, some key deal developments are discernible over the last financial year. These are outlined briefly here.

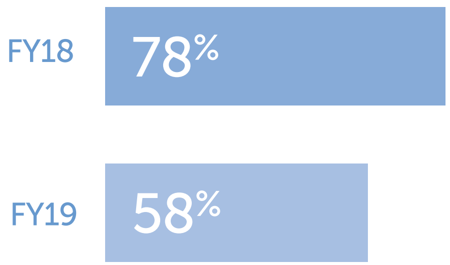
Creativity and flexibility are becoming the keys to success

As auctions for control become more prevalent, and as announced deals become more susceptible to disruption by activist shareholders, dealmakers have responded to these challenges by becoming more creative. For example, the tactics for succeeding in auctions are becoming more sophisticated than just throwing more money at the target – which of course still remains a powerful tactic! However, target boards assessing competing proposals are rightly focusing on factors beyond the headline price. Likewise, private equity acquirers are becoming increasingly innovative and flexible to secure identified targets. This includes teaming up with superannuation funds and with senior management of the target. Similarly, we saw a number of examples where, in response to shareholder activism, acquirers and/or target boards were prepared to either 'stare down' the activist or be flexible in adapting transaction terms.

Deals announced by private equity bidders



% of deals involving a foreign acquirer



Developments in the deal landscape

Three noteworthy key developments are:

- An **increased use of transaction and process deeds** as a prelude to entering into a formal implementation agreement for friendly deals. This is most likely in response to an elongation in the lead time from an initial, non-binding indicative approach to a formal implementation agreement. This longer period is often attributable to more extensive due diligence processes and more protracted negotiation over valuation and pricing. As a result, prospective acquirers and targets are now each investing more time in the pre-announcement period - with no certainty that a deal will get done. They are therefore each documenting protections into transaction and process deeds to allocate risk and sunk costs if no formal proposal emerges from the now invariably longer pre-announcement negotiation phase.

- The increasing willingness of boards of ASX listed targets and their shareholders to **accept foreign listed scrip as consideration in friendly deals**. This reflects a growing recognition that Australia is a small part of a global investment market. Boards and shareholders in ASX listed targets are increasingly attuned to that. They are therefore increasingly receptive to substituting some or all of their investment in an ASX listed target for shares in an acquirer that is listed on a reputable foreign exchange.

- **Australian superannuation funds are becoming key players in M&A transactions,** either as co-investors with private equity or industry participants and/or as conduits to delivering a pre-bid stake. The sheer weight of the funds means they will no longer be passive in M&A deals, but will instead drive and shape M&A activity.

An overarching prediction

Section 4 of this report contains our outlook for the remainder of FY20 including sectors to watch. Although we've identified a number of sectors that we believe are amenable to M&A activity, there is always an element of crystal ball-gazing with industry predictions. However, one overarching prediction is this. Most industry sectors are subject to rapid change and disruption, mainly driven by unprecedented advances in technology and the relentless drive for innovation. Increased competition from innovative start-ups who have built new, disruptive technologies can quickly collapse barriers to entry and erode the market positions of established companies. As a defensive response, established companies will increasingly look to acquire an emerging or disruptive challenger. In many industries, the speed with which companies need to respond to technological disruption cannot be done without M&A.

The level of regulatory scrutiny is intensifying

In FY19, ASIC showed an increased willingness to intervene in public M&A transactions. For example, on four occasions in FY19, ASIC either withheld its no-objection letter to a proposed scheme or appeared at the first Court hearing to oppose a scheme. ASIC has continued its resolute focus on independent experts' reports, both in terms of their quality and in relation to hostile bidders seeking to discredit or critique independent experts' reports which conclude that an offer is neither fair nor reasonable.

ASIC has always had a key oversight role in schemes and takeovers. However, ASIC is stepping up its level of oversight in response to transaction structures that are becoming more bespoke, novel and/or complex, which in turn is being driven by the creativity and flexibility we have noted previously. ASIC is vigilant to ensure that bespoke, novel or complex transaction structures do not offend the cornerstone regulatory principles; namely, that any change of control transaction should take place in a market that is fully informed, efficient, competitive and in which all shareholders of the target have sufficient time to consider the proposal and an equal opportunity to participate in it.

In schemes, Courts are becoming increasingly attentive to governance issues in the exercise of their supervisory jurisdiction. This is best illustrated by the string of recent (and conflicting) cases that have considered the question of whether or not a director of a target who stands to receive a personal benefit if the scheme succeeds (for example, a cash bonus or accelerated vesting of their options or performance rights) should be disqualified from making a public voting recommendation to shareholders.

Other regulators continue to play a key role, such as the ACCC which again demonstrated its preparedness to block contentious high profile deals (eg the TPG/Vodafone merger). The ACCC has also foreshadowed the introduction of a rebuttable presumption that a proposed acquisition will lead to a substantial lessening of competition. FIRB continues to keep a close eye on transactions in sensitive sectors such as healthcare, critical infrastructure, and agriculture, with physical and electronic access to premises and data, as well as food/supply chain security being the key considerations.

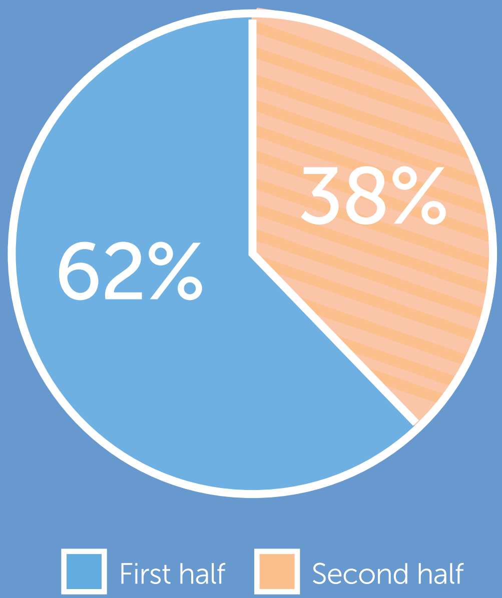
FY19 at a glance

Deal Value

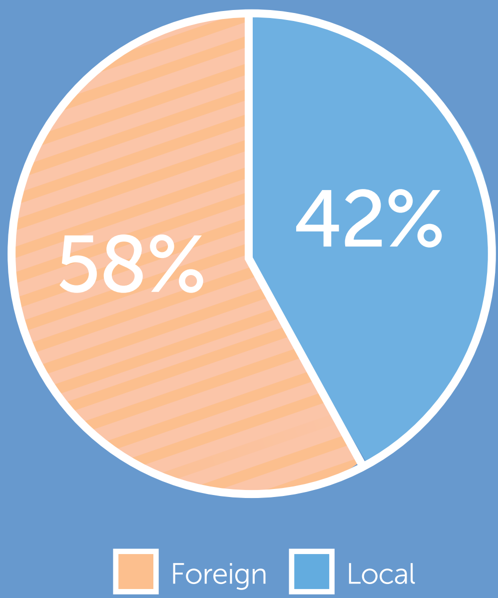
45 announced deals valued at $50million or more

$48.44bn

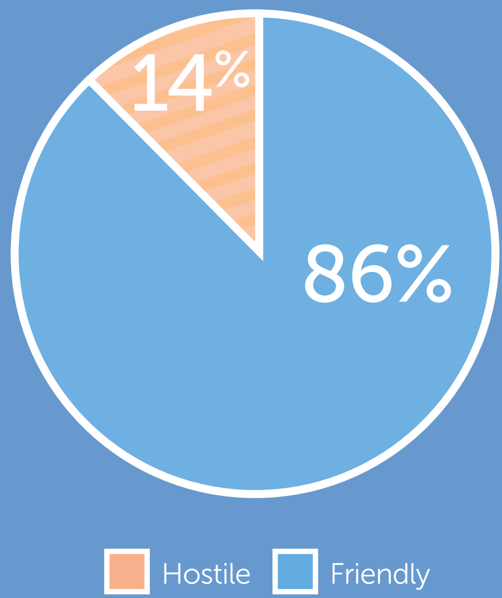
Deal Volume



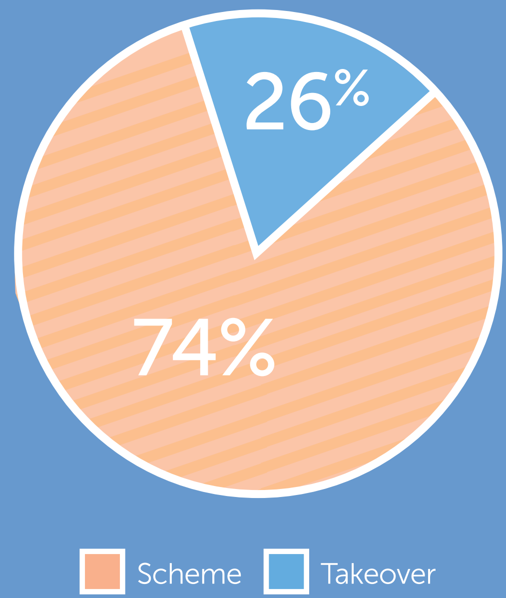
Bidder Type



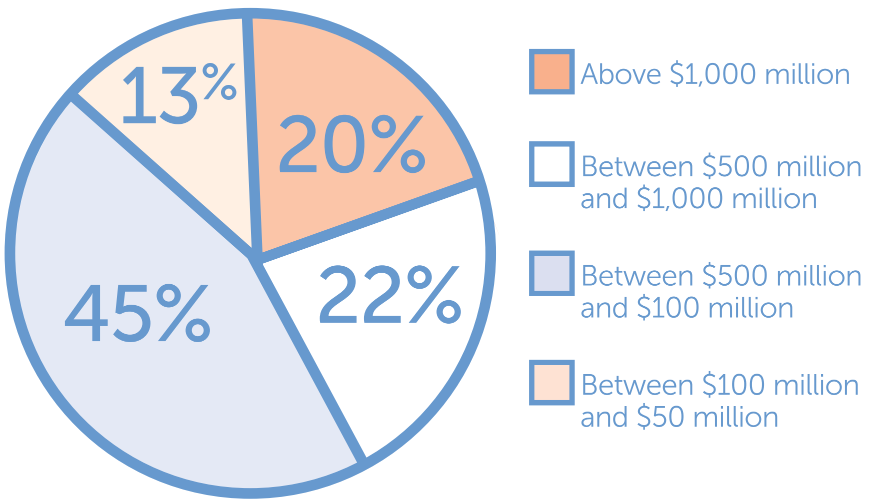
Friendly or Hostile



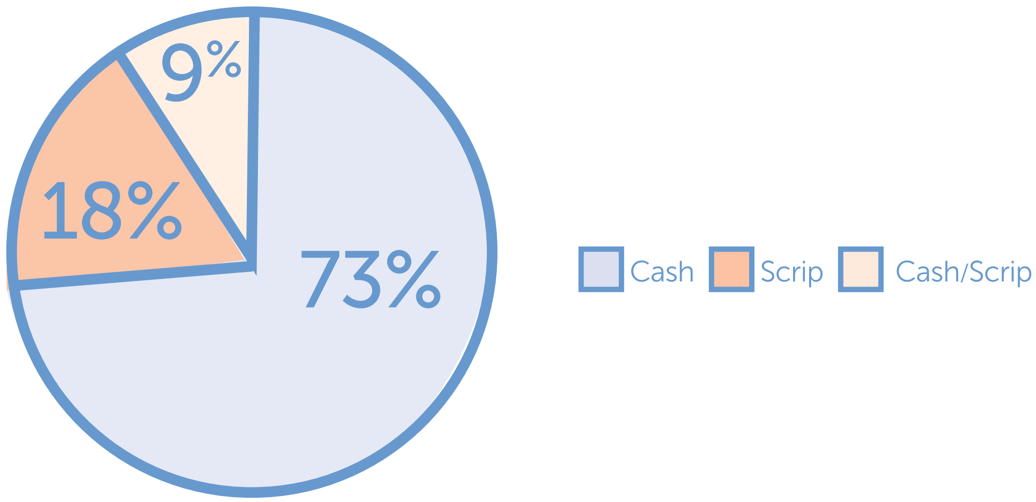
Friendly: Scheme or Takeover?



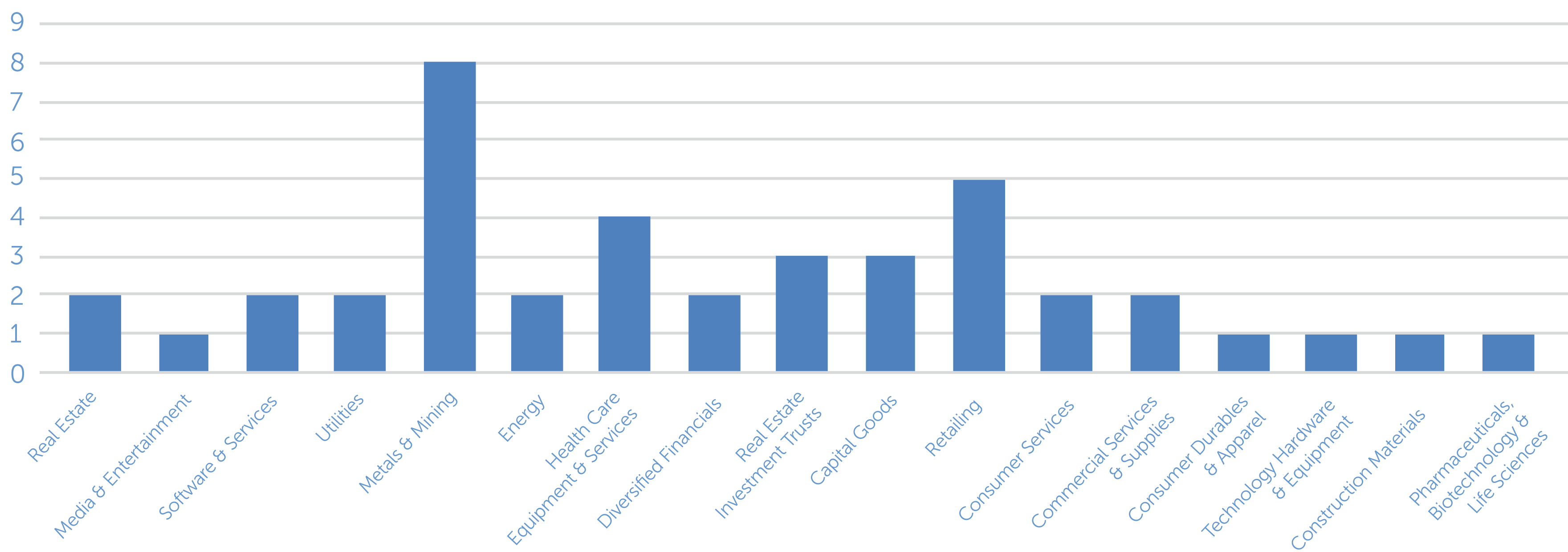
Deal Value



Consideration Type



Deals by Industry

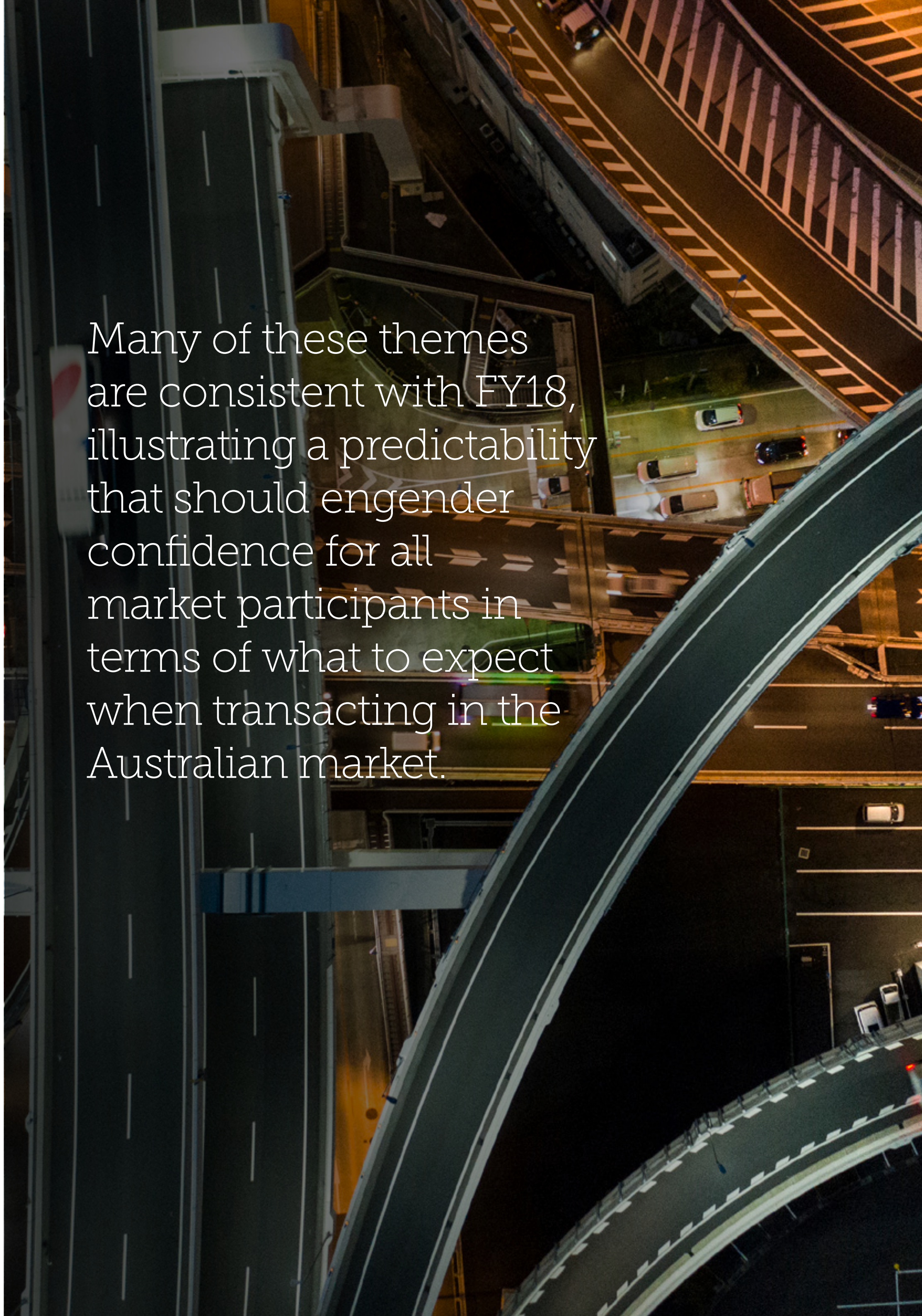


Note: Three deals had no applicable GICS code, therefore are not counted in diagram.

FY19 trends

Our FY19 data supports seven key trends and themes:

1. Auctions for control remain prevalent in the Australian public M&A landscape
2. Private equity continues to be a key driver of Australian public M&A activity
3. Foreign bidders continue to dominate
4. The mid-market remains the epicentre of M&A deal activity
5. Cash continues to be king – although foreign listed scrip is becoming increasingly acceptable
6. Shareholder activism continues to impact deals
7. Schemes are still favoured for friendly deals



Many of these themes are consistent with FY18, illustrating a predictability that should engender confidence for all market participants in terms of what to expect when transacting in the Australian market.

1 Auctions for control remain prevalent in the Australian public M&A landscape

Consistent with FY18, there were a number of vigorously contested auctions for control of ASX listed targets in FY19. Highly motivated acquirers appreciated the strategic value of potential targets and were prepared to bid aggressively in response to competition from other prospective acquirers.

Notable auctions for control in FY19 included the following targets: Gateway Lifestyle Group; Xenith IP Group, Healthscope, Eclipx Group and GBST Holdings Limited.

These auctions for control illustrate that industry participants remained determined to secure strategic assets in FY19. As bidders become more determined to secure strategic assets, we are seeing more aggressive tactics to win auctions for control. For example:

- **Offering a knock-out price** – FNZ won the auction for control of GBST by considerably upping the ante following the receipt of multiple competing proposals, with FNZ securing the GBST board's recommendation at a price 54% above the initial offer price that commenced the auction.
- **Acquiring a potential blocking stake** – IPH demonstrated its resolve to acquire Xenith through its outright purchase of a 19.9% stake in Xenith. IPH publicly stated it would vote that 19.9% stake (being the maximum stake allowed under Australian takeovers law) against the scheme proposal that Xenith had initially publicly recommended from the first suitor, QANTM Intellectual Property. Similarly, Hometown Australia acquired a stake of 18.2% in Gateway Lifestyle Group through the combination of purchasing an 8.9% stake outright, supplemented by entering into pre-bid call option agreements with shareholders for a further 9.3%. This stake proved strategically important in ultimately winning the auction for Gateway Lifestyle Group.
- **Offering flexibility with cash and scrip offers** – as IPH's successful counter-bid for Xenith shows, if a counter-bidder is itself listed on the ASX, it often helps to offer target shareholders a combination of cash and listed scrip, together with flexibility for target shareholders to elect to receive all or most of their consideration in the acquirer's shares. This flexibility is attractive to those target shareholders who prefer to maintain their current investment exposure in an industry sector by taking up shares in the listed acquirer who will then control the target.
- **Offering commercial incentives to engage** – when Hometown Australia made its takeover offer for Gateway Lifestyle Group, it indicated that it would be willing to increase its offer from \$2.25 to \$2.30 per share if Gateway entered into a bid implementation agreement (incorporating the usual board recommendation and associated deal protections). In the GBST auction for control, the board of GBST was prepared to grant exclusivity to SS&C at a lower price than what FNZ initially offered, taking into account factors including:
  - the scope of due diligence requested;
  - the potential impact on GBST's commercial position should either FNZ or SS&C be provided access to due diligence and subsequently withdraw their non-binding indicative offers;
  - the quantum and terms of the exclusivity break fee; and
  - overall provisions of the Process and Exclusivity Deeds FNZ and SS&C were willing to agree to.
- **Dual track scheme and takeover structure** – a dual track scheme and takeover offer structure was successfully employed by Brookfield in the auction for Healthscope. This may be a viable future option for acquirers who are prepared to accept less than 100% ownership of a target company. The dual track structure may be particularly useful where a shareholder in the target (who may be a competing bidder) holds a stake large enough to potentially vote down the scheme.

As tactics in auctions for control become more aggressive and creative, target boards assessing competing proposals are rightly focusing on factors other than just the headline price. Target boards are also comparing the relative execution certainty of competing offers. Execution certainty in turn requires an assessment of each suitor's funding capacity, the level of conditionality attached to the competing offers and the likely timing for satisfaction of each suitor's regulatory and other conditions.

2 Private equity continues to be a key driver of Australian public M&A activity

Private equity continued to be a driving force in Australian public M&A in FY19 (see table).

Deals announced by private equity bidders accounted for 17.9% of the total value of our FY19 deal sample, compared to 17.5% last year. We expect this high level of private equity interest in ASX listed companies to continue for the remainder of FY20, partly because debt funding remains cheap and partly because private equity funds are actively seeking assets across a broad range of industries in which to invest their capital.

Private Equity Bidder	Target	Deal Value	Method	Status
ROC Partners Wattle Hill Capital (joint bidders)	Capilano Honey Ltd	$199m	Scheme	Successful
Adamantem Capital Liverpool Partners Jonathan Lim (non-executive director, Zenitas) Shane Tanner (non-executive chairman, Zenitas) (joint bidders)	Zenitas Healthcare Limited	$109m	Scheme	Successful
Affinity Equity Partners	Scottish Pacific Group Ltd	$700m	Scheme	Successful
TPG Capital	Greencross Ltd	$669m	Scheme	Successful
Oaktree Capital	Billabong International Ltd	$198m	Scheme	Successful
Ascend Global Investment Fund Golden Energy and Resources (joint bidders)	Stanmore Coal Ltd	$239m	Takeover	Unsuccessful
Apax Partners	Trade Me Group Ltd	$2.56bn	Scheme	Successful
KKR & Co	MYOB Group Ltd	$2.01bn	Scheme	Successful
BGH Capital AustralianSuper Rodney Jones (Director, former CEO) (joint bidders)	Navitas Ltd	$2.08bn	Scheme	Successful
Adamantem Capital	Legend Corporation Ltd	$79m	Scheme	Successful

Private equity activity in FY19 traversed a wide range of industries, including:

- Health Care Equipment & Services
- Diversified Financials
- Energy
- Retailing
- Software & Services
- Consumer Services
- Capital Goods

Private equity acquirers are becoming increasingly innovative with their acquisition structures to secure identified targets. For example, we are seeing:

- **Joint bids between smaller private equity acquirers.** Smaller private equity acquirers are prepared to jointly pursue attractive targets that would otherwise exceed their funding capacity if pursued on an individual basis.
- **Consortium bids by private equity acquirers.** Private equity acquirers are prepared to team up with superannuation funds. For example, BGH Capital made an ultimately unsuccessful joint bid for Healthscope with AustralianSuper, which was also a 10% shareholder of Healthscope, with AustralianSuper committing to not support another bid, even if it was a higher offer.
- **Private equity teaming up with target management.** Private equity acquirers are prepared to form a consortium with key board and senior management representatives of a target. For example, Bain Capital's ultimately unsuccessful proposal for BWX, BGH's successful acquisition of Navitas and Adamantem Capital's successful acquisition of Zenitas Healthcare all involved co-participation by key board and senior management of the target. This is driven by private equity seeing the benefit of not just retaining and leveraging the industry experience of key executives of the target but also giving them a meaningful direct equity stake.
- **Continued use of stub equity offer structures.** Private equity acquirers continue to offer target shareholders the opportunity to receive some of their consideration in the form of unlisted shares in the private equity holding company. Examples of these so-called 'stub equity' offerings by private equity in FY19 included TPG Capital's acquisition of Greencross and Wattle Hill Capital and ROC Partners acquisition of Capilano Honey. However, ASIC has expressed concerns with certain aspects of these stub equity offerings. ASIC is looking to restrict stub equity to protect retail investors for whom such equity might carry significant risk without accompanying disclosure in the form of a prospectus (see further on page 23).

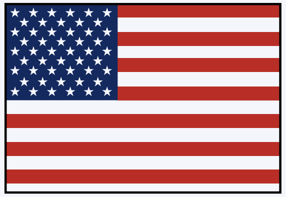
Additionally, we are seeing private equity funds being willing to adopt flexible structures to secure target board recommendations. For example, when KKR was negotiating its acquisition of MYOB Group, KKR was prepared to agree to a 'go shop' provision to support a lower revised offer price following declines in the MYOB share price during its negotiations. Under the terms of the 'go shop' right, MYOB was permitted to solicit competing proposals, with a commitment from KKR that it would sell its pre-existing 20% shareholding in MYOB into, or vote in favour of, any superior proposal that emerged from MYOB's 'go shop' process.

We expect private equity firms to continue to drive high levels of interest in companies in defensive industries (including in the healthcare and aged services, utilities, and energy industries), particularly where those companies appear to be materially undervalued or poorly performing. Schemes are likely to continue as the preferred acquisition structure for private equity, given the greater certainty of timing and outcome that a scheme offers compared to a takeover bid.

3 Dominance of foreign bidders continues

The appetite for foreign investment in Australia remains strong, despite our relatively complex foreign investment regime. FIRB requirements are deliberately drafted very broadly and capture many more transactions than commonly thought. In FY19 we saw foreign bidders continue to dominate, with 58% of deals in our deal sample involving a foreign acquirer (either as the bidder or a member of a consortium).

Consistent with recent years, strongly represented foreign inbound bidders in our sample included USA, Canada and Japan.



United States

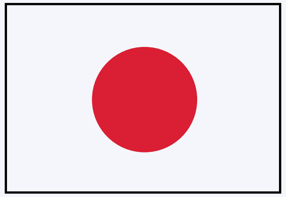
As in FY18, United States bidders made up the majority of foreign bidders in FY19. This is unsurprising given the long standing ties between the US and Australia. Aside from the perceived low sovereign risk in Australia and the strategic positioning of Australian businesses in the Asia-Pacific region, this trend has been bolstered by US-based private equity firms acquiring Australian companies (see the examples cited in the table on page 10).

Canada

The Canadian inbound deals in our FY19 sample were in sectors in which the TSX and ASX are exchanges of choice for listing including:

- Mining & Resources – example transactions included:
  - Cobalt 27 Capital Corp's acquisition of Highlands Pacific Ltd; and
  - Great Panther's acquisition of Beadell Resources Ltd.
- Medicinal Cannabis – example transactions included our Toronto headquartered client, PharmaCielo Ltd's announced acquisition of Creso Pharma Ltd.

Interestingly, both the Beadell Resources and Creso Pharma acquisitions were structured as schemes where the consideration was foreign listed scrip: shareholders in both of these ASX listed targets were offered shares in a Canadian listed entity. Traditionally, foreign acquirers recognise that the best acquisition currency for ASX listed targets is cash, as the perception is that Australian investors are generally reluctant to accept foreign listed scrip (even if it is listed on a recognised exchange and is liquid) due to unfamiliarity with foreign companies and exchanges. Despite this, the success of recent schemes involving foreign listed scrip (e.g. Great Panther/Beadell Resources, LIFULL/Mitula, Unibail Rodamco/Westfield, and Bemis/Amcor) suggests Australian retail and institutional shareholders are increasingly open in control transactions to receiving foreign listed scrip as consideration. However, we suspect this openness will continue to be confined to scrip in companies listed on reputable and well established foreign exchanges.



Japan

Japanese inbound investment into Australia remained strong in FY19. Notable public market examples included:

– Kokusai Pulp & Paper Co. Ltd's acquisition of Spicers Ltd by scheme of arrangement;

– Nippon Paint Holdings Co. Ltd's acquisition of DuluxGroup Ltd by scheme of arrangement.

Japanese policymakers are actively encouraging local companies to expand offshore and develop new geographic markets.

4 The mid-market is the epicentre of M&A deal activity

The majority of activity in FY19 was in the mid-market space, which we characterise as being deals valued at between \$50m–\$500m. 26 out of the 45 deals in our FY19 sample fell within this range.

There were nine 'mega deals' in FY19 – deals valued at more than \$1.0bn: Fairfax Media (Nine Entertainment Holdings), APA Group (CKM Australia), Investa Office Fund (Oxford Properties Group), Trade Me Group (Apax Partners), MYOB Group (KKR & Co), Healthscope (concurrent scheme and takeover bid by Brookfield), Navitas Ltd (BGH Capital), and DuluxGroup Ltd (Nippon Paint).

5 Cash continues to be king – although foreign listed scrip is becoming increasingly acceptable

Cash continued to be the preferred form of acquisition currency in FY19 (75% of bids were all cash). Likely contributing factors include:

- the low cost of debt funding due to ongoing low interest rates;
- increased volatility in equity prices – bidders who see targets as strategic acquisitions are likely to take advantage of market volatility and make cash bids, knowing that the psychology of the certainty of receiving immediate value in cash can be very attractive to shareholders in an environment of high volatility; and
- the prevalence of foreign bids
- foreign bidders recognise that shareholders of an ASX listed target will generally prefer to receive cash rather than foreign listed scrip of the bidder. (However, as noted earlier, there are increasing market examples illustrating that if that scrip is listed on a well-known, reputable foreign securities exchange, boards of ASX listed targets are prepared to publicly recommend scrip offers from foreign bidders, and Australian shareholders may be willing to accept foreign scrip offers).

As these factors have maintained a constant presence in global capital markets in recent years, we expect the prevalence of cash consideration to continue.

6 Shareholder activism continues to impact deals

Shareholder activism remains an embedded risk in the M&A deal landscape that can impact an announced deal's success. This trend, which has been growing over time, is now embedded in the Australian deal landscape. This activism can emanate from a dedicated activist fund or an institutional shareholder. It can also come from an industry competitor who buys (further) shares in the target on-market to build a stake sufficient to either torpedo an announced deal to protect its market position or to give the industry competitor a 'seat at the table' in extracting a side deal with the acquirer. Acquirers and target boards need to anticipate a potential activist intervention, be pragmatic and nimble when responding to activist intervention and be prepared to either hold firm on or adapt their transaction terms. Some examples of shareholder activism in response to publicly announced M&A transactions in FY19 include:

Northwest Healthcare - Healthscope

When the Canadian listed REIT Northwest Healthcare emerged with a 10.1% interest in Healthscope in May 2018, it publicly stated that this was a strategic stake to give it a 'seat at the table' in relation to the purchase of certain Healthscope real estate assets. The successful acquirer, Brookfield, entered into a range of interlocking side deals with Northwest Healthcare and Healthscope relating to the sale of 11 hospitals, in return for which Northwest Healthcare agreed to vote its stake in favour of the scheme.

MYOB Group – Manikay Partners

On 24 December 2018, MYOB Group announced that it had entered into a scheme implementation agreement with KKR & Co (which held a pre-existing 20% stake in MYOB) under which KKR & Co would acquire the remaining shares that it did not hold in MYOB Group for $3.40 per share. This deal was announced at a time when Australian equities had fallen sharply, with the S&P ASX200 at 5,493.80 on 24 December 2019. In February 2019, Manikay Partners, a US based hedge fund who was a pre-existing MYOB Group shareholder, emerged as a substantial holder with voting power of 7.48% in MYOB Group. Over the next month Manikay Partners increased its voting power to 16.15%.

In the course of increasing its MYOB stake, Manikay Partners undertook a public campaign against the MYOB Group board's recommendation of KKR's offer of $3.40, including publicly releasing an open letter to the MYOB Group chairman which was critical of the Board's continued recommendation, in light of improving share market conditions. Manikay Partners also sought to receive early access to the independent expert's report and challenged the release of the scheme booklet at the first court hearing.

In late March 2019, KKR publicly confirmed that its $3.40 offer was its best and final offer (in the absence of a competing offer). Following this development, Manikay Partners wrote to the Chairman of MYOB Group advising that it would vote in favour of the scheme; however, not without some parting criticisms.

7 Schemes still the preferred structure for friendly deals

In FY19, 86% of deals in our sample (being 39 out of 45 deals) were friendly transactions. Of those friendly transactions, 74% (being 29 out of 39 deals) were structured as a scheme of arrangement. This trend is consistent with last year's (where 77% of friendly deals were structured as schemes of arrangement), and is unsurprising. Schemes offer:

- **Certainty of outcome, with an 'all or nothing' result** – if a scheme is approved by target shareholders and the Court, 100% control of the target will pass to the acquirer; on the other hand, if the scheme fails, the target's current ownership structure continues;
- **Certainty of timing** - if a scheme is approved by target shareholders and the Court, it will be implemented on a fixed date, with 100% control passing to the acquirer on that date; and
- **A lower shareholder approval threshold to achieve 100% control**, compared to the 90% compulsory acquisition threshold for a takeover bid.

These benefits are especially attractive to private equity acquirers. In our FY19 sample, eight out of nine deals involving private equity bidders were structured as schemes.

8 out of 9

deals involving private equity bidders were structured as schemes in FY19

Getting the deal going: early stage practices in public M&A

In FY19, we saw some noteworthy early stage deal practices:

- The increasing use of transaction process deeds at the front end of a potential friendly control transaction; and
- A renewed appetite by some target boards for electing to voluntarily disclose the receipt of non-binding offers for strategic or tactical reasons – sometimes with adverse consequences for the deal, sometimes with spectacularly successful results.

Increasing use of transaction process deeds

We're seeing an increased use of transaction and process deeds as a prelude to entering into a formal implementation agreement for friendly deals. This is most likely in response to an elongation in the lead time from an initial, non-binding indicative approach to a formal implementation agreement. This longer period is often attributable to more extensive due diligence processes and more protracted negotiation over valuation and pricing. As a result, prospective acquirers and targets are now each investing more time in the pre-announcement period - with no certainty that a deal will get done. They are therefore each documenting protections into transaction and process deeds to allocate risk and sunk costs if no formal proposal emerges from the now invariably longer pre-announcement negotiation period.

Transaction and process deeds often include terms covering the following matters:

- the grant of exclusive due diligence access and protection of confidential business information (this used to be the exclusive domain of a confidentiality deed);
- the grant of full-form exclusivity provisions to the prospective acquirer – these full form exclusivity provisions are ordinarily only incorporated into an implementation agreement for a fully developed, formal proposal that is capable of being submitted to shareholders;
- a commitment to negotiating in good faith the implementation agreement; and
- cost protection provisions, including reverse break fees – for example, the obligation by the suitor to pay a reverse break fee to the target if an implementation agreement is not entered into in certain circumstances. We have also seen the converse provision where the target is obliged under a process deed to pay the suitor a cost reimbursement fee if the suitor, having completed its due diligence, reaffirms its commitment to proceeding at the price specified in the initial non-binding offer, however, the target then withdraws.

These provisions aim to put protections in place for both parties to ensure their investment in time, due diligence and advisory services is appropriately covered if no formal proposal ultimately eventuates.

Voluntary disclosure of non-binding indicative offers – a cautionary reminder

A key issue for target boards to consider is whether to publicly disclose the receipt of a non-binding indicative offer. The ASX had made it clear that non-binding indicative offers are not required to be disclosed (provided confidentiality has not been lost). Nevertheless, there may be strategic or tactical reasons why a target may elect to voluntarily disclose a non-binding, preliminary approach from a prospective acquirer (such as to signal that the target is potentially in-play and to test the market for other interest, with a view to creating an auction for control).

The decision for a target board on whether or not it makes sense to voluntarily disclose a non-binding preliminary approach is nuanced. It very much depends on the specific circumstances of the transaction. However, the risks associated with voluntary disclosure were vividly illustrated by a number of examples in FY19:

- **Crown Resorts** – Crown Resorts announced a non-binding indicative approach from US based casino and resort operator Wynn Resorts in April 2019 on the back of media speculation of an approach. This announcement led to Wynn Resorts immediately withdrawing from discussions.

- **Vocus** – in late May 2019, Vocus announced that it had received a non-binding indicative proposal from EQT Infrastructure. Vocus then announced in early June 2019 a separate non-binding indicative proposal from AGL Energy. Both parties were provided with due diligence access. However, neither preliminary approach ultimately proceeded any further, with both prospective acquirers withdrawing within a short space of time after being granted due diligence access. Vocus was then forced to confirm the termination of both sets of discussions to the market, including managing market speculation as to whether there were any matters identified in due diligence that deterred both prospective acquirers.

- **Universal Coal** – in September 2018 Universal Coal announced that it had received a non-binding indicative proposal from a consortium of investors led by a South African private company, Ata Resources. Universal Coal continued to provide updates well into 2019 on the progress of negotiations which it intended would culminate in execution of an implementation agreement. In April 2019 Universal Coal announced that it had received another non-binding indicative proposal from AFRIMAT, and that it could not currently recommend Ata Resources' proposal. In July 2017 AFRIMAT undertook a period of due diligence, but ultimately determined not to proceed with the proposal.

In contrast, the auction for control of GBST illustrates that early voluntary disclosure of a non-binding indicative offer can quickly flush out alternative proposals and maximise the price at which control of the target passes.

Directors' benefits and recommendations in schemes: navigating the new landscape

In any proposed scheme of arrangement to accomplish a friendly takeover, the target directors' public voting recommendations to shareholders are of central importance. Potentially complicating these recommendations is that one or more target directors are often eligible to receive some form of personal benefit if the scheme proceeds (in addition to the benefit they are entitled to receive under the scheme if they are also shareholders). For example, an executive director may be offered a cash bonus if the scheme is implemented or the (partial) acceleration or waiver of vesting conditions attached to their performance rights and/or options. The Corporations Act's disclosure-based regime determines how the receipt of these contingent personal benefits intersects with the director recommendation framework for schemes.

The issue of whether disclosure alone is now sufficient has been brought into sharp question by a line of recent, conflicting cases. Deciding whether or not a target director who stands to receive a personal benefit should make a voting recommendation fundamentally impacts how a deal is structured and publicly presented (e.g. determining whether an independent board committee needs to be formed). It also has reputational implications for directors. This remains a live, fluid issue. Some guiding principles from the cases to date are as follows:

- At the earliest possible stage of a scheme transaction, each target director should consider the benefit of independent legal advice around any additional personal benefit they stand to receive if the scheme is successful. They need to consider if the benefit is of such a magnitude that it could affect their own objective assessment of the scheme and, if so, whether it should it preclude them from making a voting recommendation. This should be addressed during the negotiation of the scheme implementation agreement.
- The target's board, without the relevant director present, should specifically consider whether or not it is appropriate for that director to make a recommendation on the scheme despite the nature and quantum of the benefits which he or she will receive if the scheme proceeds.
- The value of the contingent personal benefit should 'be not out of the ordinary and within the scope of what might be considered commercially not unreasonable.
- A specific clause should be drafted into the scheme implementation agreement that modifies the usual 'unanimous' director recommendation obligation. It should expressly preserve the flexibility of a target company's director to not make a recommendation (or to not continue to maintain a recommendation) if he or she determines that their interest in the scheme is so materially different from other shareholders that they are precluded from providing (or continuing to provide) their recommendation.
- Prominent disclosure must be given of the contingent additional personal benefit, as this will allow shareholders to assess what weight should be given to the relevant director's recommendation.

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FY19 industry hotspots

Metals & Mining

Real estate investment Trusts

Medical Adjacent industries (Health Care Equipment & Services, and Pharmaceuticals, Biotech and Life Sciences)

As predicted last year, metals & mining led the way in FY19 with eight deals out of our sample of 45 falling within this industry. Companies in this sector pursued M&A activity as a direct pathway to acquire proven resources assets, rather than pursuing potentially riskier and more expensive exploration activity. Examples included:

- Cobalt 27 Capital Corp's acquisition of Highlands Pacific Ltd, to gain exposure to a proven nickel-cobalt mine;
- Xuchen International's acquisition of Nzuri Copper Limited by scheme of arrangement, to gain exposure to Nzuri's Copper and Cobalt mines in the Democratic Republic of the Congo; and
- Wesfarmers Lithium's acquisition of Kidman Resources, to gain exposure to the global lithium industry and leverage its experience in chemical processing and operating processing plants.We also saw junior miners seeking to consolidate into larger miners, including with a focus on pure resources plays. For example:
- Doray Minerals and Silver Lake Resources merged to focus on Western Australian based gold production; and
- Sandfire Resources and MOD Resources merged to build its global development pipeline of base metals mines.

Activity in healthcare and adjacent industries was driven by private equity and industry participants looking for strategic acquisitions of defensive assets for predictable cashflows. Adamantem Capital and Liverpool Partners' acquisition of community healthcare provider Zenitas Healthcare is an example of private equity looking to acquire healthcare companies with predictable revenue that have been under-priced by the market. Another example is Brookfield's acquisition of Healthscope.

The retail industry was also the focus of M&A activity in FY19. Continuing pressures facing retailers in Australia include a decline in the value of bricks and mortar property assets, subdued consumer sentiment and intensifying competition from online retailers. These pressures have translated into softening retail demand and performance, which in turn have prompted:

- opportunistic bids for listed retailers who have reported weakened financial results – for example, the Geminder family's hostile on-market bid for The Reject Shop (which closed with the bidder securing 18.99%); and
- private equity making offers to acquire retailing businesses with perceived defensive characteristics and growth potential – examples of this activity involved private equity funds, for example:
  - PG Capital's acquisition of vet clinic and pet store owner Greencross Ltd by scheme of arrangement to capitalise on increasing pet ownership and willingness of owners to spend on their pets; and
  - Apax Partners' acquisition of New Zealand based online auction house Trade Me by scheme of arrangement to capitalise on burgeoning second hand online sales.

Retail industry participants in a position of strength have taken advantage of changed industry conditions by buying growth and scaling up: e.g. Landmark's acquisition of RuralCo by scheme of arrangement, and AP Eagers' scrip acquisition of Automotive Holdings Group.

Metals & mining led the way in FY19 with eight deals out of our sample of 45 falling within this industry. Activity in healthcare and adjacent industries was driven by private equity and industry participants looking for strategic acquisitions of defensive assets for predictable cashflows.

Regulatory landscape

ASIC
Australian Securities & Investments Commission

In FY19, ASIC continued to demonstrate vigilance to ensure that public M&A transactions comply with the key regulatory principles that any change of control transaction should take place in a market that is fully informed, efficient, competitive and in which all shareholders of the target have sufficient time to consider the proposal and an equal opportunity to participate in it. Here are some examples of ASIC's strong oversight of public M&A transactions:

Intervention in schemes

In FY19, there were four schemes where ASIC either withheld its no-objection letter or appeared at the first Court hearing to oppose the approval of a scheme. Some of the key issues we have seen ASIC focus on in schemes are:

Bidders offering stub equity in control transactions

Stub equity refers to shares or other securities in an unlisted company that are offered under a scheme (or takeover). Stub equity allows target shareholders to elect to retain on-going exposure to the target company under the acquirer's private ownership. This is a mechanism sometimes used by private equity acquirers.

In late 2018, our clients Wattle Hill Capital and ROC Partners acquired Capilano Honey by scheme of arrangement. Our clients offered Capilano shareholders the opportunity to receive stub equity, but with an added fundraising element that was expressly permitted by the Corporations Act. ASIC withheld its no-objection letter. ASIC submitted that the Court should not approve the scheme. ASIC's concern was that it was contrary to public policy for an Australian proprietary company – which Australian law stipulates can only have a maximum of 50 shareholders - to offer unlisted shares to more than 50 shareholders of Capilano Honey, but to combine the offer with a custodian arrangement to avoid exceeding the 50 shareholder limit.

ASIC argued that its public policy concerns were not addressed by the extensive disclosure made to Capilano shareholders in the scheme booklet. That disclosure identified the risks and disadvantages of holding unlisted securities, including that the issuer would not be subject to the same governance and disclosure requirements as a public company and would not be subject to the takeover provisions. ASIC's concerns were noted by the Court but the Court ultimately chose to approve the scheme with the stub equity structure intact.

ASIC then initiated a public consultation process in relation to tightening the rules around offers of stub equity. ASIC is proposing to modify the Corporations Act to:

- restrict stub equity offers so that Australian proprietary companies cannot be the company in which stub equity is offered; and
- the stub equity cannot be issued to a custodian on behalf of investors where that issue to a custodian would result in the stub equity company not being subject to disclosing entity or takeovers provisions of the Corporations Act.

ASIC is due to release its response to the consultation process imminently.

Potential class creating issues

In the Brookfield/Healthscope scheme, ASIC withheld its preliminary no-objection letter and appeared at the first Court hearing to oppose the making of orders convening the scheme meeting. ASIC took the view that the Canadian listed REIT, NorthWest Healthcare, the holder of a stake of approximately 10.1% (later increased to around 13%), should form a separate class for voting on the scheme.

NorthWest Healthcare acquired its initial 10.1% interest in Healthscope using a derivative, and publicly stated that its intention in acquiring that stake was to give it 'a seat at the table' to acquire certain Healthscope real estate assets. Brookfield and Healthscope therefore entered into interlocking agreements to sell those assets to NorthWest Healthcare in connection with the proposed scheme, in exchange for NorthWest Healthcare agreeing to procure that the holders of the shares underlying its derivative voted in favour of the scheme.

Healthscope proposed to resolve ASIC's concerns by providing a voting report in relation to NorthWest Healthcare's votes. This was to enable the Court to consider the class issue at the final hearing under its fairness discretion. Despite this, ASIC appeared at the first Court hearing and said that when the arrangements involving NorthWest Healthcare were considered in terms of their overall commercial magnitude and nature, NorthWest Healthcare was akin to a joint proponent of the deal, and this should justify treating them as a separate class for voting on the scheme. Brookfield and Healthscope opposed ASIC's position on the basis not only that it was contrary to long-established principles regarding the constitution of classes for scheme voting, but also because ASIC's approach would have the result of magnifying the voting impact of the 19.9% stake held by BGH/Australian Super consortium (a competing bidder for Healthscope).

Ultimately the Court noted ASIC's concerns as relevant considerations in relation to class definition but ruled that the arrangements involving NorthWest Healthcare were not sufficient to justify creating separate classes. It determined that Healthscope's proposed voting report would allow the Court to consider the impact of NorthWest Healthcare's votes at the second hearing under its fairness discretion.

These two examples demonstrate ASIC's propensity to carefully review the design of complex, novel or bespoke scheme transactions.

Independent experts

In FY19, ASIC continued its focus on independent experts' reports in public M&A transactions. Two of ASIC's key concerns are:

- inadequate or absent internal process documents on the part of experts such as transaction specific checklists, templates and policy documents; and
- absent working papers, which ASIC is concerned do not provide sufficient evidence of work undertaken by experts during their engagements such as conflict checks, valuation calculations and analysis and file notes of in person and telephone conversations.

ASIC has publicly stated that it is willing to undertake licensing or enforcement action where standards are not met by independent experts. Accordingly, independent experts should be aware that their work in public M&A transactions, is likely to face increased regulatory scrutiny going forward.

Self-serving critiques of independent experts

In FY19, ASIC continued its focus on hostile bidders undertaking self-serving public critiques of independent experts' reports commissioned by targets. The example below illustrates this continued focus:

ASIC's concern remains that if a hostile bidder publicly expresses a view about what an independent expert retained by the target could or should conclude, this is capable of misleading target shareholders. This is because the bidder (and/or its retained expert) will not have access to the same level of information that the target's independent expert does. It is clear ASIC wants to discourage hostile bidders delivering a subjective, self-serving critique of independent expert reports commissioned by targets.

Stanmore Coal

In late 2018 Golden Investment launched a hostile takeover bid for Stanmore Coal, offering $0.95 per Stanmore Coal share. Stanmore Coal's target statement included an independent expert's report from BDO Corporate Finance (QLD) which valued Stanmore Coal at between $1.48 and $1.90 a share and which concluded that Golden Investment's offer was neither fair nor reasonable.

In response to BDO's report, Golden Investment commissioned its own expert's report from Grant Thornton, which concluded that Stanmore Coal was only worth $0.84 and $1.10 per share (with Golden Investment's offer of $0.95 being well within this alternative range). ASIC took issue with Grant Thornton's report because it expressed a view of what BDO should have concluded, without Grant Thornton undertaking its own analysis in accordance with Regulatory Guide 111.

Accordingly, Grant Thornton re-issued its report with mark ups, and Golden Investments re-released this report as part of a supplementary bidder's statement.


MinterEllison

Takeovers Panel

In April 2019 the Takeovers Panel released a consultation paper regarding the proposed revision of Guidance Note 20 – Equity Derivatives. The approach since 2008 has been that the Panel expects disclosure in the form of a substantial holder notice if the aggregate long position of a person and their associates (e.g. physical holdings and other exposure such as derivatives) exceeds 5%. However, the Panel generally did not require disclosure if the aggregate long position had no connection to a potential change of control transaction.

Under the revised version of Guidance Note 20 proposed by the Panel, the position is simplified. The Panel expects disclosure whenever the long position of a person and their associates is 5% or more, and if so, where that position changes by at least 1% or falls below 5% (in line with the equivalent position for physical holdings). Whether or not the holder of that position is potentially contemplating a control transaction would no longer be relevant to the need to make disclosure. The Panel believes that disclosure of all long positions over 5%, irrespective of a potential control transaction, promotes an efficient, competitive and informed market. Under the proposed revised guidance note, the Panel also notes that derivative positions which exceed the 20% threshold may give rise to unacceptable circumstances.

The consultation period has concluded but the Panel has not yet issued its revised Guidance Note. Despite this, assuming the revised guidance is issued substantially in the same form as the consultation draft, it will significantly change the use of derivatives in pre-bid planning as well as by shareholder activists by requiring disclosure where none was previously required. In this regard, it will be interesting to see what disclosures are made by strategic shareholders in ASX listed companies after any revised guidance is issued.

Merger clearance activity in FY19

In FY19, the ACCC:

- Pre-assessed 306 confidential merger matters
- Undertook 25 public reviews
- Released four Statement of Issues (SOI)

In terms of the 25 transactions subject to public review in FY19:

- 17 were cleared
- Five cleared conditionally through undertakings (Transurban/Westconnex, CK Consortium/APA Group, Bingo/Dial-a-Dump, Thales/Gemalto, Knauf/USG)
- Two were opposed: (TPG/Vodafone, Pacific National/Aurizon)
- One was withdrawn/ discontinued (Siemens/Alstom)

Blocks to broadband deal
The ACCC blocked a proposed merger of TPG and Vodafone, prompting the merger parties to file in the Federal Court to have the deal approved. While the parties' activities are largely complementary, the ACCC was concerned the merger would reduce competition and contestability on the basis that – if the deal did not proceed - TPG would roll out its own mobile network and provide added competition in the mobile services market as a vigorous fourth player. The case hinges on whether there is a real chance that TPG would renew its plans to roll out its own network, after deciding to shelve its plans to do so. The merger parties criticised the ACCC's decision, claiming it would 'only serve to further entrench the enormous power of Telstra and Optus'. An expedited hearing was heard in September 2019 and is awaiting judgement.

Acquisitions of minority interests are also on the ACCC's radar
The ACCC expressed preliminary competition concerns about Qantas' completed acquisition of a 19.9% interest in Alliance Airline, highlighting how the acquisition of a non-controlling or minority interest can still attract the ACCC's attention in connection with section 50 of the CCA. This reinforces the point that, from the ACCC's perspective, the acquisition of a minority or non-controlling interest can raise potential competition issues. This is due to the potential that the minority or non-controlling shareholding would alter the parties' incentives to compete, might act to limit fundraising or block alternative pro-competitive transactions or lead to information flows between competitors. As at the end of October, the matter remains under ACCC consideration.

Another recent example of the ACCC's interest in an acquisition of a minority or non-controlling shareholding was the acquisition by IPH Limited of a 19.9 per cent stake in Xenith IP Group Limited. IPH did not notify the ACCC of this transaction, and the ACCC opened up an investigation into the acquisition under section 50 of the CCA shortly after the announcement. (IPH subsequently applied for, and was granted, ACCC clearance to acquire all the shares in Xenith).

New merger authorisation process now proven avenue in public M&A
FY19 saw the first use of the new merger authorisation process. This replaced the former merger authorisation and formal clearance processes in 2017 and placed the ACCC into the position of first instance decision maker.

The new process was used by AP Eagers Ltd to seek clearance of its acquisition of Automotive Holdings Group Ltd, a competing automotive retailing group. While the new authorisation process permits public benefit arguments to be made (and weighed against competitive detriments), the AP Eagers application was made solely on competition grounds. The ACCC conditionally authorised the transaction, following an undertaking from AP Eagers to sell its existing new car dealerships in the Newcastle and Hunter Valley region of NSW to a third party.

The ACCC considered the application and made an authorisation decision within the 90 day statutory timeframe, without an extension. This timing saw the ACCC issue market inquiries within two days of the application being filed, a market feedback letter approximately seven weeks after the application was made, followed by consultation on the proposed divestment undertaking two weeks later. Approximately 28 submissions from interested stakeholders were published on the ACCC's register, along with the application, ACCC correspondence and other material.

The successful use of the authorisation process demonstrates the viability of this clearance avenue in the context of public M&A, where certainty of timing can be critical.

Potential shifts in the 'substantially lessening competition' standard...
The ACCC's chairman, Rod Sims, has advocated in recent times for a rethink of what is required to establish a 'substantial lessening of competition'. He has raised concerns that the evidentiary bar for establishing a likely substantially lessening of competition is set too high and that recent cases such as Pacific National/Aurizon illustrate the '*significant hurdles*' faced by the ACCC in opposing mergers in Court, where the ACCC has the burden of proving that the acquisition is likely to contravene section 50.
The ACCC has expressed concern that '*the Tribunal and the courts appear to give greater weight to evidence from parties to the transaction, who have a vested interest in the acquisition proceeding, rather than the evidence from third party witnesses.*'

This has led the ACCC to more recently lobby for the introduction of a rebuttable presumption that a merger does substantially lessen competition.
If introduced, this would be a significant shift in Australia's merger control regime

Australian Government
Foreign Investment Review Board

The return of the Morrison Government at the 2019 federal election has resulted in continuity of the policy settings around foreign investment into Australia. While this means that the screening thresholds for transactions in the agricultural space in particular remain low, the continuity should give investors additional comfort about the process and likely outcome of any application to the Foreign Investment Review Board (FIRB).

Cyber security and data protection have been a main focus for the FIRB this year, with the FIRB Chair flagging that data security is as important as critical infrastructure when reviewing potential acquisitions by foreign investors.

The focus on data protection has extended beyond protecting sensitive national security data, which has always been a focus for FIRB for investments in data centres and the like. It now will also include a heightened focus on the protection of sensitive personal data. This increased focus coincides with (or likely was triggered by) an increased interest from foreign investors in the Australian healthcare sector. The standard 'data protection conditions' have been modified and expanded, and now arguably have more operational impact than previously.

Various foreign investors have also seen an increase in the number of property access conditions being applied to no objection notifications throughout 2019, particularly where there is a government tenant at the property that is the subject of the proposed transaction. These conditions have included requirements to notify tenants of the transaction, and also restrictions on the access rights of the foreign investors once owners of the property (even if already covered by the relevant lease).

The ATO has also continued to play a key role in the FIRB assessment process. Compliance monitoring (including audit) and enforcement activities are continuing to receive additional attention. We understand that FIRB has also seen a noticeable increase in the number of foreign investors needing to seek retrospective clearances for unintentional breaches, which can presumably be attributed to the breadth and complexity of the regime.

In public M&A transactions the keys to a successful FIRB outcome – both in terms of the actual decision and also the time needed to obtain that decision – remain:

1. Early identification of the need for FIRB clearance – noting that the FIRB regime is complex, deliberately drafted very broadly and captures many more transactions than commonly thought;
2. Prior engagement with FIRB on any potential sensitivities (including with the ATO or the ACCC in particular); and
3. Prompt lodgement of the FIRB application once the transaction structure and parties are locked down.

Outlook and predictions for remainder of FY20

1 With organic growth slowing, expect to see greater reliance on growth by acquisition

With organic growth remaining challenging across many mature industries, any meaningful growth will need to be achieved by acquisition. For that reason alone, M&A levels in Australia for the remainder of FY20 are likely to remain steady. Strategic acquirers will always be prepared to 'look through' short-term geopolitical headwinds such as the eventual outcome of Brexit and the oscillating economic tensions between the world's two largest economies, China and the United States.

2 Opportunistic bidders will remain ready to pounce

Bidders will continue to move quickly to take advantage of quality targets whose share prices are depressed or languishing due to broader adverse industry sentiment rather than any fundamental problems with the underlying business.

Out of favour and heavily sold sectors such energy and aged care may now be on the radar of opportunistic bidders.

Hostile bids that are put directly to target shareholders will remain a viable option for many opportunistic acquirers whose initial attempts at friendly engagement are rebuffed by target boards. See for example the hostile all-scrip bid launched by Independence Mining for Panoramic Resources on 4 November 2019, following unsuccessful initial attempts at friendly engagement with the Panoramic Resources' Board. As this recent example illustrates, immediately transitioning to a 'Plan B' hostile bid – or even by-passing the usual 'Plan A' friendly engagement path and launching into a hostile bid from the outset remains open. This is despite the inherent execution risks of hostile bids (e.g. due diligence being confined to publicly available information, and no break fee or other deal protection if overbid).

3 Innovation will drive private equity bids for ASX listed companies

Private equity buyers will continue to use innovative structures to secure a pre-bid stake, secure a target board's recommendation or overcome obstacles to getting the deal done.

4 Australian superannuation funds will become key players in M&A transactions

This will be either as co-investors with private equity or industry participants and/or as conduits to delivering a pre-bid stake. The sheer weight of Australian superannuation funds means they will no longer be passive in M&A deals, but will instead drive and shape M&A activity. Australian super funds may replicate the patterns seen overseas, such as in Canada, where pension funds are major direct investors in publicly listed companies, both locally and in overseas markets (such as Australia).

5 Continued strong foreign investment due to our stable government and strategic location relative to Asia

Dealmakers should seek FIRB advice early and plan for the potential need for FIRB approval including early engagement with FIRB. This is particularly the case given the complexity and breadth of our FIRB regime which captures many more deals than direct foreign acquisitions.

6 Foreign listed scrip will become increasingly acceptable

As boards of ASX listed targets and their shareholders become increasingly attuned to the global investment market, we expect to see an increased willingness by ASX listed companies to agree to friendly deals with foreign bidders where the consideration is or includes the bidder's own foreign listed scrip.

7 Continued use of transaction process deeds

As the timeframe from initial informal approach to a formally announced deal continues to increase, we expect to see a greater use of transaction process deeds. This reflects an increasing desire for certainty and protections in the pre-announcement period including cost recovery mechanisms if a formal proposal does not eventuate.

8 Continuing shareholder activism

Already we're seeing shareholder activism in a number of announced FY20 deals. For example, we've seen Wilson Asset Management unsuccessfully campaigning for a higher offer from Nine in its takeover bid for the 45% of Macquarie Media that Nine does not already own; we've seen Thorney Opportunity Fund publicly criticise the directors of Aveo Group for recommending an offer from Brookfield at a price that was materially below Aveo's most recent valuation of its net tangible assets (that deal ultimately succeeded); and we've also seen interests associated with media executive Antony Catalano increasing their existing stake in Prime Media Group from just below 5% to 10.3%, with a view to either thwarting Seven West Media's proposed acquisition of Prime or using this enlarged stake to negotiate a commercial win for Mr Catalano's newspaper business.

9 Climate change reporting may impact deal activity

In August 2019, ASIC updated its guidance on climate change related disclosure, RG 228 (prospectus) and RG 247(annual reporting), reflecting the climate change risks developed by the G20 Financial Stability Board's Taskforce on Climate Related Financial Disclosure. This increased focus by companies on climate change reporting will continue to impact Board strategy, especially potential divestments and a more selective approach to the types of acquisitions Boards are willing to pursue as part of their longer term strategy. However, this may not deter private equity from capitalising on the vacuum of deal options in this space by stepping in to acquire unloved assets.

10 Regulators will continue to flex their muscle

ASIC will continue to be vigilant in reviewing complex, novel or bespoke transaction structures. The ACCC will continue to closely monitor industry consolidation plays, as well as acquisitions by industry competitors of strategic minority stakes. FIRB will continue to closely review transactions in sensitive sectors including healthcare and agribusiness to ensure that they are not contrary to Australia's national interest.

Likely HOT sectors:

- Health & aged care: we expect this to remain a 'hot' sector for a number of reasons:
  - A global ageing population drives increased demand for healthcare services,
  - Aged care listed stocks have been significantly impacted by the ongoing Royal Commission, presenting an opportunity for prospective acquirers who understand this industry to pursue an opportunistically timed and priced acquisition.
  - The healthcare industry is consolidating as businesses search for ways to reduce costs and drive efficiencies;
  - High levels of regulation will continue to pose significant hurdles for smaller businesses, encouraging mergers to create sufficient scale as a method of survival; and
  - Private equity will continue to look to healthcare businesses for defensive assets with steady cash flow.
- Infrastructure
- Mining and Minerals: we expect to see continued consolidation of junior and mid cap companies as well as acquisitions of companies to gain access to Australia's significant proven natural resources.
- Consumer Staples: we expect this sector to heat up over the next year as private equity and other investment managers look to potential defensive acquisitions in the face of global volatility.

COLD sectors:

- Telecommunications: the ACCC has made it clear that it will closely scrutinise future M&A activity in the telecommunications sector due to a high level of consolidation. We predict this will continue have a chilling effect on industry players (although we may see some activity from private equity looking for smaller defensive assets).
- Consumer Discretionary: while we expect the consumer staples sector to heat up in terms of deal activity over the next year, we expect that businesses in the consumer discretionary sector are unlikely to be the subject of public M&A as retail performance flags in Australia.

An overarching prediction

Technological disruption and innovation to drive M&A activity

Most industry sectors are subject to rapid change and disruption, mainly driven by unprecedented advances in technology and the relentless drive for innovation. Increased competition from innovative start-ups who have built new, disruptive technologies can quickly collapse barriers to entry and erode the market positions of established companies. In response to a rapidly changing technological and competitive landscape, established companies can either look to build internal technological innovation or buy it. However, in many cases, acquiring an emerging or disruptive challenger will often be a necessary defensive response. In many industries the speed with which companies need to respond to technological disruption cannot be done without M&A. The "buy versus build" decision will often lead to a conclusion that acquiring is the fastest path to respond to structural changes in an industry. To unlock the capital to fund these defensive acquisitions, we expect to see companies increasingly reviewing their asset portfolio and divesting non-core assets that are not part of their future growth strategy.