



# DIRECTIONS IN CAPITAL MARKETS 2018



MinterEllison

# INTRODUCTION

Welcome to the fourth edition of MinterEllison's Directions in Capital Markets report, part of our annual Deals Trilogy.

We are pleased to present our observations on trends in equity and debt capital markets (ECM and DCM, respectively) in FY18 and our predictions for FY19.

Our observations are primarily based on our analysis of market data for the financial year ended 30 June 2018. In ECM we analysed data sourced from the Australian Securities Exchange (ASX). In DCM, we focused on analysing credit data from the Reserve Bank of Australia, specifically growth in loans from non-bank financial institutions as non-bank lending and non-bank M&A rise. We also looked at global DCM activity over the past five years to get an overall picture on current trends that will affect local markets.

Our report:

- identifies six key ECM trends and two key DCM trends in FY18;
- discusses the role played by key Australian regulators;
- makes nine predictions for FY19; and
- provides a list of five hot sectors to watch.

MinterEllison played a central role advising on many of the capital markets transactions profiled in this report. We trust that our report provides some interesting perspectives and is a useful resource for you.

## FY18 AT A GLANCE

**A\$33.9B**

IN EQUITY CAPITAL RAISED  
(DOWN 34.6% FROM 2017)

**2018  
DEAL  
COUNT**  
JAN 2018-  
OCT 2018

**A\$25.7B**

IN IPOs BY MARKET CAP  
(UP 80.4% FROM 2017)

**A\$9.8B**

IN SHARE PLACEMENTS  
(DOWN 52.2% FROM 2017)

**A\$6.8B**

IN RIGHTS ISSUES  
(DOWN 20% FROM 2017)

**2**

MEGADEALS (IPOs OVER  
A VALUE OF \$1 BILLION)

**110**

MID-MARKET DEALS  
(INCLUDING SECONDARY  
RAISINGS) BETWEEN THE  
VALUE OF A\$50M AND A\$500M

**TOTAL  
DEAL  
COUNT**

**477**

**TOTAL  
SECONDARY  
RAISINGS**

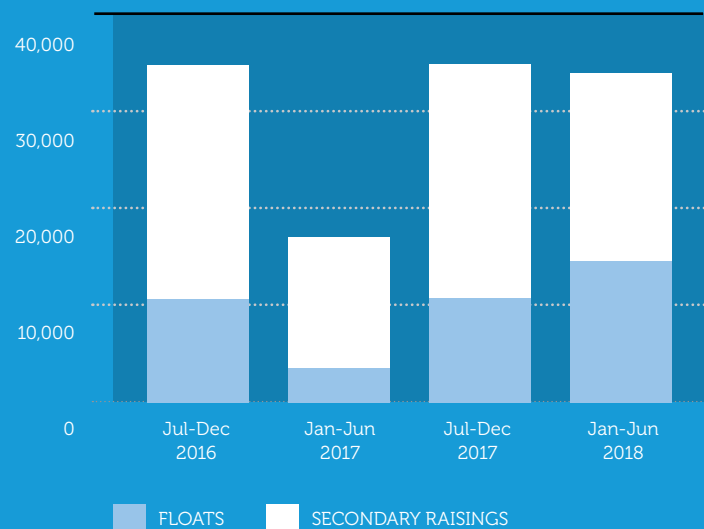
**415**

**TOTAL  
FLOATS**

**62**

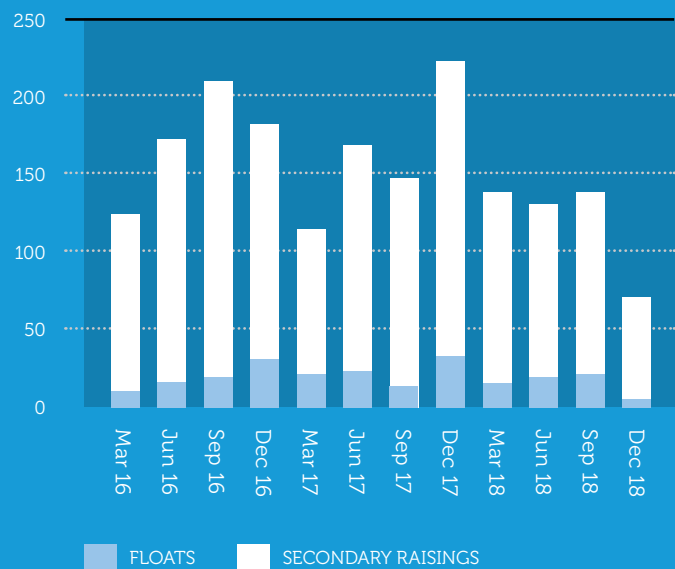
Source: ASX

## AUSTRALIAN ECM CASH ISSUE (\$M)



Source: ASX

## AUSTRALIAN ECM DEAL COUNT

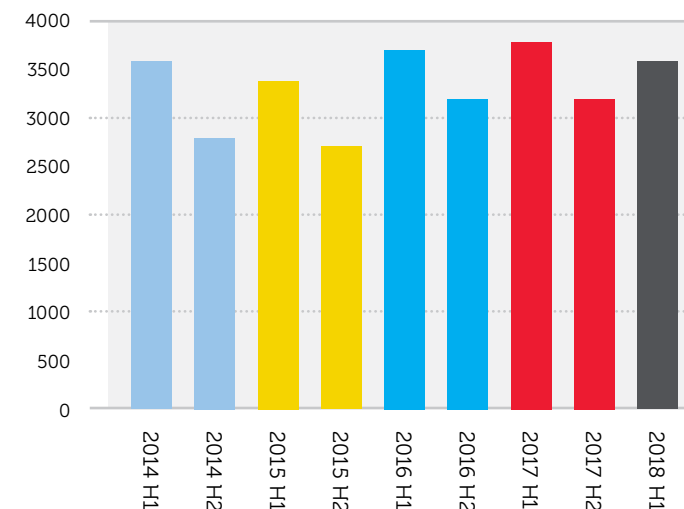


Source: CapitalIQ

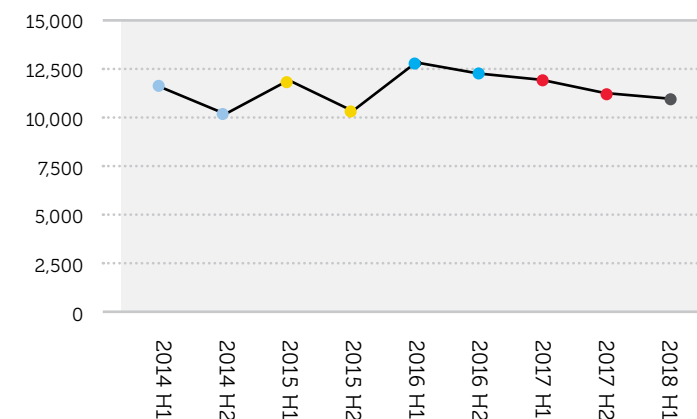
## FY18 DCM AT A GLANCE

Global DCM markets had a relatively strong start to the year. First quarter volumes showed their second strongest initial quarter since 2013, and the third largest in total for the past 10 years. Despite hefty volume, more recent bond activity has been affected by interest rate hikes in the US and instability in global stock markets. These sentiments have also been felt in Australia, where DCM activity has slowed down considerably as credit spreads have widened.

## GLOBAL DCM - VOLUME (US\$B)



## GLOBAL DCM - NUMBER OF DEALS



Source: dealogic

# KEY ECM TRENDS IN FY18



## 1. Deals that keep on giving – equity raising to fund M&A

Equity capital and secondary raisings fell for a second consecutive year in a cooling market. While Australian ECM activity was subdued, there was still some movement with many ASX-listed acquirers raising funds to pay cash consideration for targets. The bulk of these offerings took the form of rights issues and were well supported by existing shareholders looking for a level of growth beyond the organic. While the cost of debt funding remains low due to historically low interest rates, the success of these equity offerings may be reflective of investors rewarding companies for not repeating the mistakes of the global financial crisis and maintaining gearing at moderate levels.

**Notable equity raises to fund M&A activity included:**

### Case study:

## oOh!media's capital raising to fund the acquisition of Adshel

oOh!media acquired street furniture advertising business Adshel from H&TE Limited for \$570 million. The acquisition was part funded by way of a fully underwritten \$330m accelerated non-renounceable entitlement offer.

Adshel's business complements oOh!media's existing portfolio. oOh!media announced that it expected the digitisation opportunity in the Adshel business to provide a significant avenue for further growth.

Key to success of the acquisition was the capital raising, which helped oOh!media to successfully secure this avenue for further growth and receive full financial backing by way of full underwriting by Macquarie Capital.

The capital raising was successful despite the uncertainty associated with the acquisition. The Adshel deal was conditional to receipt of ACCC approval. The process was complicated by ACCC's earlier rejection of a proposed merger between oOh!media and competitor APN Outdoor, and by the announcement of a merger transaction between APN Outdoor and JCDcaux SA one day after the announcement of the Adshel deal. Ultimately, the oOh!media / AdShel transaction received approval and was completed.

MinterEllison advised oOh!media on this deal.



## 2. Flavoured REITs continue to be palatable – particularly in food and agri

As predicted in our previous *Directions in Capital Markets*, both real estate investment trusts (REIT) with sectoral exposures and also the agribusiness and food sectors continue to come forward as quality IPO candidates.

### Case Study: Vitalharvest

Vitalharvest's objective is to provide investors with exposure to real agricultural property assets whose earnings profile and underlying value are exposed to the growing global agricultural demand for nutritious, healthy food. The initial assets comprise one of the largest aggregations of berry and citrus farms in Australia which are split over approximately 3,700 hectares and 130 property titles located across New South Wales, Tasmania and South Australia. The assets are leased to Costa Group. Vitalharvest's properties were independently valued at \$238.4 million by CBRE and provide agricultural diversification by way of crop type, climatic region, water source and product end markets.

Vitalharvest achieved a \$185 million IPO of the Vitalharvest Freehold Trust on ASX. This IPO is unique in representing the first standalone agricultural REIT of major citrus and berries properties across a number of Australian states.

Issuer	Target	Acquisition value	Equity raising value
oOh!media Limited	Adshel	A\$570 million	A\$329.9 million
Bellamy's Australia Limited	Camperdown Powder	A\$28.5 million	A\$60.4 million
Reliance Worldwide Corporation Limited	John Guest Holdings	A\$1.22 billion	A\$1.10 billion
Link Administration Holdings Limited	Capita Asset Services	A\$1.49 billion	A\$883 million
Woodside Petroleum Limited	50% interest in Scarborough Gas	approx. US\$1.2 billion	A\$2.5 billion
Yancoal Australia Limited	Coal & Allied	US\$2.69 billion	US\$2.5 billion

# KEY ECM TRENDS IN FY18



## 3. Hot or not? The ups and downs of listed investment vehicles

As discussed in our *Directions in Private Equity* report, the 2018 financial year saw the greatest amount of alternative funding raised by Australian and foreign managers operating in Australia. This included funding raised in the listed market, including around \$800 million by MCP Master Income Trust (managed by Metrics Credit Partners) and \$175 million by Gryphon Capital Income Trust (managed by Gryphon Capital Investments).

There was also a good number of more traditional listed investment vehicle IPOs, including some of the largest ever by Magellan Global Trust and L1 Long Short Fund. However, FY18 also saw a reasonable number of proposed listed investment vehicles fail to execute their IPOs.

What drove the success or failure of these listings? It was a case of the good, the bad and the ugly.

### Case Study: MCP Master Income Trust

Metric Credit Partners established MCP Master Income Trust, a listed investment trust holding a diversified portfolio of credit investments. The Trust listed on the ASX in October 2017 by way of a \$520 million IPO. In early 2018, significant investor demand saw MCP Master Income Trust back in the market with a capital raising of up to \$381 million which was structured as a 1 for 1.7 pro rata non-renounceable entitlement offer and associated top-up placement. This capital raising was novel in that it involved a back-end placement to retail investors.

The Trust invests in units in the MCP wholesale investments trust, cash at bank and other assets in accordance with its stated investment strategy. This is the provision of monthly cash income, low risk of capital loss and portfolio diversification by actively managing diversified loan portfolios and participating in Australia's bank-dominated corporate loan market. The IPO was the first of its kind on ASX and has generated a large amount of interest from investors and other product issuers who have noted the strong success of the MCP Master Income Trust.

The Trust's structure is innovative and it has disrupted the retail credit space by providing retail investors with exposure to investments which are normally illiquid and/or reserved for institutional investors. In an environment where investors are struggling to find stable and reliable income sources, the MCP Master Income Trust provides long term surety of income for investors.

MinterEllison advised Metric Credit Partners and the responsible entity for the MCP Master Income Trust in relation to all aspects of the IPO and ASX listing and capital raising.



## The good

The managers whose IPOs met with success were those who offered innovative structures or products. LICs and LITs face the perennial issue of how to attract investors into a product whose fees are higher simply by reason of the listing. Products issuers like Magellan broke new ground to not only absorb the initial listing costs (ensuring that the net asset value on listing equated to the total IPO raise), but also to offer loyalty units without affecting the net asset value of the vehicle. Issuers like Metrics offered exposure to asset classes which are normally reserved for institutional investors, while also enabling a longer investment horizon than comparable unlisted products. Finally, LITs generally found favour over LICs due to favourable tax characteristics.



## The bad and the ugly

LITs and LICs flopped where the offering was not sufficiently differentiated from other alternatives (including unlisted retail funds). With the liquidity features of unlisted funds steadily being improved (see our *Directions in Private Equity* report), only listed funds with truly novel features, or asset class exposures or transparent pricing found favour with investors and advisor networks. In addition, some issuers struggled to overcome the challenge of tapping into the optimal distribution channels for these products.

Issuer	IPO size	Investment strategy
Magellan Global Trust	A\$1.55 billion	Global equities
VGI Partners Global Investments Limited	A\$550 million	Global equities
L1 Capital Kong Short Fund Limited	A\$1.3 billion	Australian, New Zealand and global equities
MCP Master Income Trust	A\$516 million	Australian corporate loans
WAM Global Limited	A\$465.5 million	Undervalued international growth entities
Gryphon Capital Income Trust	A\$175.3 million	Residential mortgage backed securities and asset backed securities with Australian domiciled issuers

# KEY ECM TRENDS IN FY18



## 4. IPOs – *from little things...?*

While FY18 saw a healthy overall number of new listings by way of IPO on ASX, they were overwhelmingly at the small cap to lower mid-market end of the spectrum. Of the 113 IPOs in FY18, only four had market capitalisations of over \$500 million.

A number of proposed very large IPOs ultimately did not proceed, with the vendors electing to sell to trade or spin the entity off. For example, Origin sold Lattice to Beach for \$1.6 billion, Brookfield, Macquarie and their co-owners sold Quadrant Energy to Santos for \$2.9 billion, while the Commonwealth Bank of Australia is spinning off its wealth management and mortgage broking business, Colonial First State Global Asset Management.

At the smaller end, however, companies with strong growth prospects, innovative business models or good industry tailwinds met with success. In this segment, investor appetite extended to a range of industries, including financial services (Evans Dixon, Netwealth and Selfwealth), resources (Jupiter Mines, Bounty Mining), renewables (Windlab and Pyrolyx) and tech and fin tech (Credible Labs, P2P Transport and Trimantium GrowthOps).

This success came despite several disclosure-related scandals involving small, recently listed companies. The allegations of non-transparency levelled at the likes of Get Swift and BigUn had the potential to put a chill on the market for new issuers at the small end. However, it appears that greater regulatory scrutiny by ASX (which stepped in quickly with revised continuous disclosure guidance) reassured the market.

Corporate  
restructures as  
part of an IPO to  
make businesses  
investment ready  
has been an  
emerging theme  
at the smaller end  
of the market.

### Case Study: Johns Lyng Group

The Johns Lyng Group Limited IPO was a pertinent example of a successful mid-market business IPO with strong earnings and prevailing industry tailwinds.

Johns Lyng Group is a leading integrated buildings services group delivering building and restoration services across Australia.

Johns Lyng Group raised \$96 million at IPO, with around 50% of the total amount raised used to fund a partial exit of the company's pre-IPO investor base. As is common with private mid-market businesses, the structure of Johns Lyng Group prior to IPO was unsuitable for a listed environment. The group comprised of a large number of sub-trusts and subsidiary companies, many of which included outside equity interests. Accordingly, and as part of the IPO, a restructure of the group occurred, which involved a roll-up of the sub-trusts and subsidiary companies in which minority or outside equity interests were held.

MinterEllison advised Johns Lyng Group on all aspects of its IPO and restructure.

# KEY ECM TRENDS IN FY18



## 5. Sticking to the core – demergers are apples

After a long hiatus, a spate of demergers have been announced. For the most part, this reflects a desire on the part of large companies to focus more on their most profitable and highest growth operations. In financial services, though, the increased regulatory scrutiny (including the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry - the Financial Services Royal Commission) has prompted disposals and spin-offs in part, to effect the much discussed objective of 'separating product and advice'.

### Demergers announced or completed:

**Coles from Wesfarmers**

**MLC from NAB**

**Colonial First State from Commonwealth Bank**

**IFCO plastic containers from Brambles**

**Petrol stations from Woolworths**

**Telco infrastructure from Telstra**

### Demergers speculated about:

**AMP**

(banking or funds management)

**Rio** (aluminium)

**BHP** (petroleum)

**Caltex** (infrastructure)

**CSL** (Behring or Seqirus)

**Wesfarmers divesting Bunnings or Officeworks**

**Premier Investments to separate international franchises** (Peter Alexander, Smiggle)

**Fairfax** (Domain spin off, subsequently abandoned due to Channel Nine's bid for Fairfax)



## 6. Tax issues with obtaining a demerger relief

During 2018, the Australian Taxation Office (ATO) refused demerger relief applications which were applied for in the context of several public transactions.

While the specific reasons for refusing demerger relief in the context of the transactions are not public, it is likely that the reasons are similar to those expressed by the Commissioner in the ATO's class ruling, CR 2018/31 (related to the demerger of OneMarket Limited from Westfield Corporation Limited prior to acquisition of Westfield by Unibail-Rodamco).

It appears that the ATO views on the "nothing else" requirement for the roll-over relief to be available for shareholders have evolved. Broadly, transactions contemplating a demerger of a business in which there is a third party wishing to acquire either the demerged business (or the demerger business) from shareholders risk falling foul of the roll-over relief requirement. This says that when shareholders acquire shares in the new company (that acquired the demerged business), they receive nothing else (such as cash or something of value).

Given the evolving view of the ATO, for transactions which contemplate a demerger followed by a subsequent sale it will be difficult to obtain demerger roll-over relief for shareholders. Accordingly, if such transactions are being contemplated, and would otherwise be expected to receive roll-over relief for shareholders, early engagement with the ATO to assess prospects of relief being available is a good idea. The ATO has indicated that it will provide guidance on its new positions in December 2018 and in early next year. The market awaits this guidance with great anticipation

# KEY DCM TRENDS IN FY18

While global DCM markets had a relatively strong start to the year with first quarter volumes showing their second strongest initial quarter since 2013, DCM activity in Australia has slowed down considerably as credit spreads have widened.

Looking more broadly across the debt markets, it is clear that key trends are being driven by the Financial Services Royal Commission. This is having a dramatic impact on the debt funding landscape, with two clear effects – strong growth in non-bank lending, and extensive non-bank M&A.

## Growth in Non-Bank Lending

Recent credit data released by the Reserve Bank has shown loans and advances by non-bank financial institutions in Australia rose by 10.3% year to year to August. This is the strongest annual growth rate in non-bank lending in a decade. What this suggests is that non-bank financial institutions have stepped into markets where the banks have otherwise started to pull back.

Non-bank lenders are not constrained by prudential regulation, so are able to remain active in markets that are becoming subject to regulatory focus. They are therefore able to react solely on the basis of market forces.

This has an impact at both the institutional and the consumer level. At the institutional level, there has been the growth of debt funds – that is, funds established for the purpose of lending to specific market sectors. These are often those that the banks have indicated a reluctance to fund in the current market environment. (Residential construction facilities are an obvious example). Further, there are many examples of superannuation funds participating directly in lending syndicates. In each of these situations, the funding would traditionally have been deposited with a bank, which in turn would on-lend the funds to the ultimate borrower. Here however, the funding is being provided directly by the fund to the borrower.

This disintermediation reflects a trend that has been evident in the offshore markets for many years.

At the consumer level, the Australian market has for many years had a strong non-bank sector, usually funded through the warehouse or term securitisation market. The volume provided by these non-bank lenders has increased substantially in the past few years – a trend which is expected to accelerate as the banks seek to reduce exposure to specific sectors. The Australian Securitisation Forum (ASF) estimates aggregate funding of residential mortgages by non-ADI lenders amounts to approximately \$12 - \$15 billion per year. This represents around 4.5% of the

\$320 billion of the annual residential mortgage loan market in Australia.

The recently announced Australian Business Securitisation Fund – a \$2 billion funding programme to support securitised lending to small business – will further support this market.

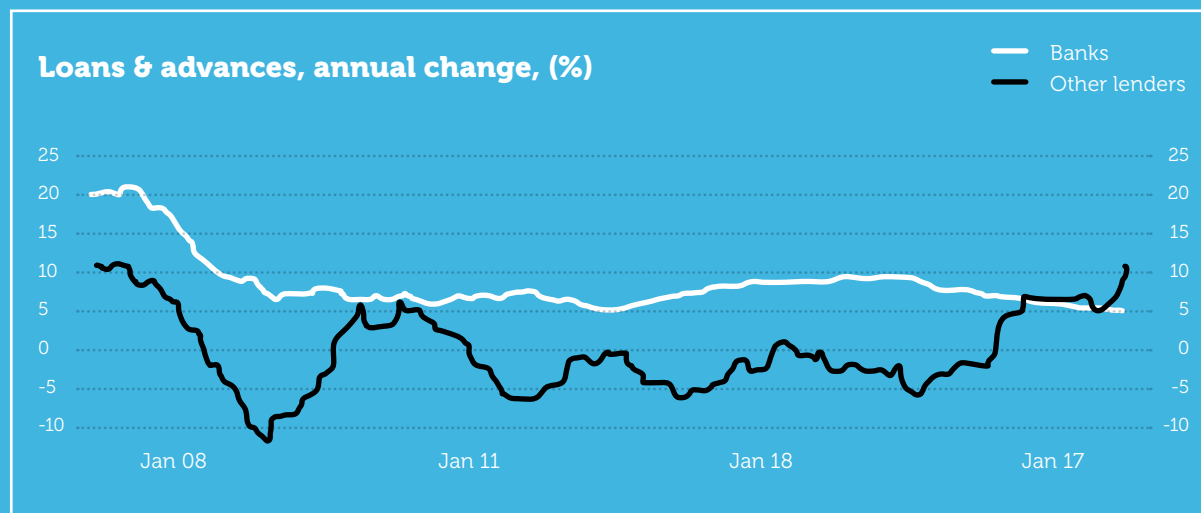
## Growth in Non-Bank M&A

The last few years have seen a number of non-bank financial institutions the subject of acquisition – such as the acquisition of La Trobe Financial by Blackstone, the acquisition of Pepper by KKR, and the acquisition of Bluestone by Cerberus.

Offshore interest in Australian non-bank financial institutions is driven by the strength and reputation of the

brands, their increasing presence in the market as a result of traditional lenders ceasing to focus on from some sectors (as noted earlier), and the opportunity for investors to diversify financial service offerings more competitively. In addition to the access to additional sources of capital, these investments also give rise to synergies for these non-bank financial institutions, including the expansion of distribution channels and additional growth opportunities in key market segments.

It is likely that these institutions will continue to primarily source their funding through the private and public securitisation markets, leading to an increased volume of issuance into these markets.





# KEY DCM TRENDS IN FY18

## Case Study: Debt Funds on the rise

An offshore pension fund established a new real estate debt fund to invest in middle-market real estate loans in Australia and New Zealand.

A new record for the amount of alternative debt funds raised in Australia was set during FY18 and we believe this type of activity will continue to grow in FY19, as debt funds fill gaps in the market.

An Australian fund manager will source and manage investments on behalf of the fund under an Investment Management Agreement.

MinterEllison acted as a deal counsel to the pension fund and advised on and documented all Fund establishment, debt capital and investment management documents, which include an initial \$500 million secured senior loan note subscription facility.

## Case Study: Essendon Fields

In October 2018, Essendon Fields – the airport and business park in Melbourne – replaced short term bank debt with a \$100 million 10 year facility provided by IFM Investors, supported by AustralianSuper and Cbus.

While Australia lacks a substantive corporate debt market per se, this is the second material private debt origination transaction in the past couple of years, with both transactions featuring AustralianSuper, IFM Investors providing long term debt and Westpac, who have arranged these transactions. Much of the attraction of private debt investing is the higher yield accessible compared to corporate bonds, and the diversification benefits it can offer.

The low level of private debt held by superannuation funds in Australia is well below that held by pension funds overseas. In Europe, the proportion of pension plans allocating to private debt (akin to the Essendon Fields transaction) increased from 7% to 11% over the past year according to Mercer. Similar trends were observed in the US, by others, three years earlier.

The RBA highlighted in a recent speech that despite growing quickly, debt financing by the non-ADI sector is only around 7% of total financial assets in Australia. This is not much changed over the past few years and significantly lower than the 12% that occurred prior to the GFC.

With 9.5% of employee earnings flowing into superannuation (and set to rise to 10% in 2021), the potential for superannuation funds to support continued long term debt facilities remains largely untapped. Most companies in the ASX200 may benefit from accessing private debt markets, along with a wide range of unlisted and private companies who are looking for long term debt finance.

## Case Study: Non-bank M&A in Australia

Blackstone, one of the largest private equity funds and the largest property investor in the world, acquired La Trobe Financial in 2017. La Trobe Financial is a privately owned, leading Australian credit and investment firm that specialises in funding and management of both residential and commercial mortgage assets. La Trobe Financial also manages one of Australia's largest retail investment credit funds with over \$1.7 billion assets under management covering approximately 22,000 retail investors.

This acquisition is a good example of an offshore investor recognising the opportunity and potential for growth of non-banks in a rapidly growing market.

# REGULATORY LANDSCAPE

## **ASIC guidance on sell side research**

ASIC issued Regulatory Guide 264 *Sell-side research* in December 2017, following an industry review in 2016 and a period of consultation in 2017. The regulatory guide sets out ASIC's views on the processes and procedures issuing companies, investment banks, corporate advisers and research firms should put in place to address:

- risks around the handling of inside information; and
  - conflicts of interest (whether between an investment bank's corporate advisory clients and its investing clients or between an investment bank's corporate advisory clients and its staff).
- In particular, the regulatory guide:
- provides guidelines for non-deal meetings, including such matters as not committing to provide research, not discussing views on valuation and analysts needing to be wall-crossed if inside information (eg about a transaction) is discussed;
  - mandates prescriptive expectations in relation to the nature and content of interactions between analysts and the company and between analysts and the investment bank's corporate advisory team. Different requirements apply depending on the stage of the transaction – pre-solicitation, pitching or post-appointment; and
  - sets out guidelines for content and processes around research reports

## **Enforcement action on bookbuilds**

ASIC has continued the scrutiny on bookbuilds which commenced during the industry review for Regulatory Guide 264. In its report on that review, ASIC noted that some underwriters:

- provided larger allocations to large institutional clients of the firm; to investors who commit to engage in buying in the after-market; to investors in compensation for losses on earlier deals; and to senior management or directors of other companies that the firm was seeking to secure as a client; and
- scaled back allocations depending on investor status (eg scaling back hedge funds) or in favour of allocations to themselves or their staff.

ASIC also noted in that report instances where inconsistent and misleading information was provided to potential investors during a bookbuild. It said that that firms should take care not to engage in misleading and deceptive conduct when advising potential investors that a book has been covered.

ASIC is now enforcing these statements. It accepted an enforceable undertaking from Goldman Sachs Australia to improve controls relating to bookbuild messaging in transactions after an investigation into the November 2015 Healthscope transaction. ASIC had concerns about certain representations made by GS to potential investors about the minimum fixed demand. As a result of the investigation and undertaking, GS implemented changes to its processes including to require:

- legal or compliance approval of all bookbuild messages to be provided to potential investors in equity capital market transactions; and
- compliance attendance at any sales calls at the launch of equity capital market transactions to provide oversight of messaging to potential investors.

## **ACCC action alleging cartel behaviour in an ECM transaction**

The ACCC (via the Commonwealth Director of Public Prosecutions) has brought criminal charges against Citi, Deutsche Bank and ANZ (as well as a number of individual employees of those organisations) in respect of alleged cartel conduct in relation to the ANZ institutional placement in 2015.

Citi, DB and JP Morgan were the joint lead managers of the placement. JPM has been granted immunity and is co-operating with the ACCC (and so is not the subject of charges).

The allegation relates to conduct associated with the disposal of the shortfall under the placement. The ACCC alleges that once the JLMs received the shortfall shares, they became competitors with respect to the disposal of those shares. The discussion and co-ordination (including in relation to price) which occurred is alleged to have contravened the cartel laws. The charges against ANZ are essentially that they aided and abetted the JLMs. The cartel laws are 'per se' offences – ie no damage or gain needs to be proved.

The outcome of the case won't be known for some time (likely years). Accordingly, investment banks should proceed with caution and consider the nature of any joint undertaking in which they are engaged.

For transactions going forward, there are a number of options (ranging from protocols around communications to attempting to take advantage of exceptions to the cartel offence), but some of these have implications under other laws and so advice should be taken to navigate these issues.

## **Initial coin offerings**

While initial coin offerings (ICOs) are continuing to increase in popularity both globally and within Australia, they remain an enigma for regulators who are seeking to regulate ICOs in a continually evolving cryptocurrency space.

During the first quarter of 2018, it was reported that capital raised from ICOs on a global basis had exceeded the total amount raised during the 2017 calendar year, with approximately \$6.3 billion being raised (an increase of 118% from 2017). The staggering increase in investor appetite in the cryptocurrency space is likely to continue to draw the attention of regulators as they seek to balance the need to protect investor interest with the competing tension of providing flexibility for capital raising in the new digital world.

# PREDICTIONS FOR FY19

## 1. Equity market valuation levels

A sell-off in global equity markets over the last two months has pushed valuation levels back to nearer their long-run averages. Globally, the trailing price / earnings (PE) ratio currently sits at around 16x, which represents a reasonable step down from the almost 18x they reached through the middle of 2018.

The chart below shows PE ratios on a geographic basis. Based on these ratios the U.S. remains the most 'expensive' equity market, while emerging markets are the cheapest. In Australia, trailing PE ratios are around 15x, which is also within the range of its long run average. Despite recent volatility, we expect that these valuations should remain supported through FY19 given the cycle

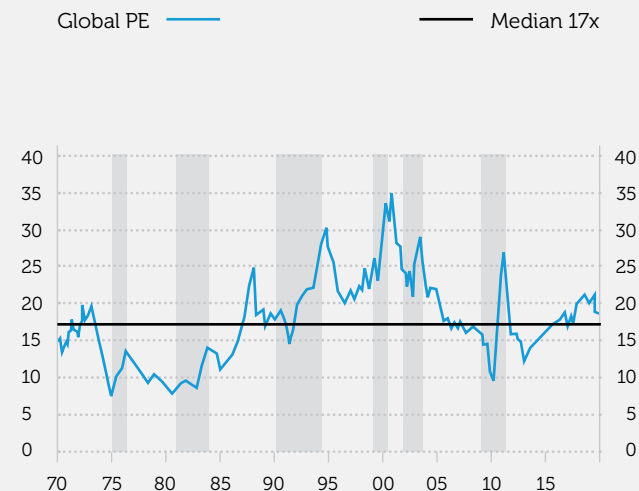
is very much now in a mature bull-market phase, and that low interest rates still prevail in Australia (and are likely to do so for the foreseeable future).

Equity issuance has already responded to the softer valuations, with a marked step-back in the pace of IPO's in Australia through 2018 versus last year. As long as market volatility remains high and global growth fears exists, the current subdued state of the IPO market can be expected to remain. At the same time, the still positive 'late-cycle' sentiments have remained through certain market segments. The clearest example of this would be the high valuations that have been seen on private equity transactions, with deal multiples of approximately 12x EV/EBITDA now being

paid (compared to an average of 9x through the years 2010-2015).

The stalled IPO candidates (created by the postponement of many IPOs in the last two to three months) will be hoping for macro stability on matters like trade and Brexit and for this positive sentiment to seep into equity markets.

**"Despite recent volatility, we expect that these elevated valuations will remain for FY19."**



## 2. Impact of Financial Services Royal Commission

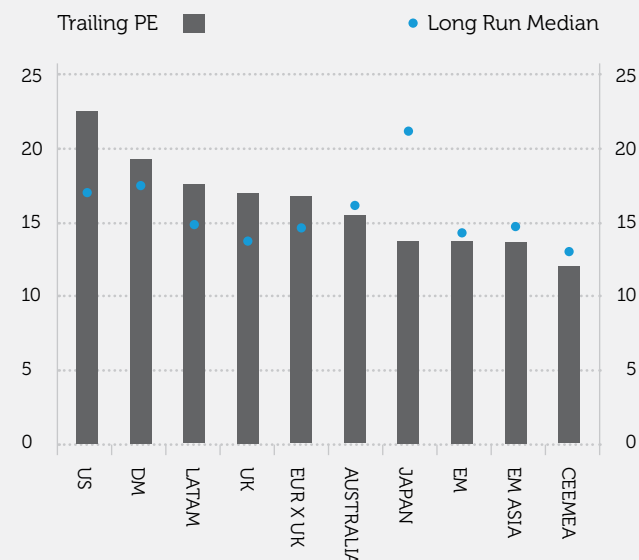
The Financial Services Royal Commission could have a chilling impact on businesses in the financial services industry looking to go public. Indeed, ASIC, in Report 589 *ASIC regulation of corporate finance: January to June 2018* states that prospectuses for such businesses should include candid information about how the business may be affected by the issues being raised in the Financial Services Royal Commission. Depending on the business model, this may include:

- relevant historical and current interaction with regulators and possible outcomes;

- the specific regulatory risks that the business may encounter, including risks relating to treatment of consumers.

The impact of this unprecedented level of scrutiny has already been seen, with the very late withdrawal of the Prospra IPO for reasons relating to concerns raised by ASIC. In addition, Latitude Financial (a sizeable credit card and personal lender and formerly GE Money Australia) has delayed its IPO several times, as it struggles to achieve an earnings multiple valuation above that of the major banks.

We consider that financial services businesses that are able to distinguish their business models from those of the incumbents will have the most success in ensuring that the Financial Services Royal Commission does not derail the prospects of the success of their IPOs.



# PREDICTIONS FOR FY19

## 3. Listed investment vehicles – will the trend continue?

The market has been saturated with listed investment vehicles undertaking IPOs in the last 12 – 18 months (with many offering similar investment strategies). However we consider that while the ability of the 'vanilla' listed investment company to pull-off a successful IPO is likely to decline, the window for managers whose investment strategies are novel or whose fee structures 'break the mould' or offer good transparency is likely to remain open.

## 4. Will real-estate investment trusts (REITs) continue in popularity?

Recent years have seen growth in the number of REITs who have successfully achieved and maintained a listing in ASX. This growth has partly occurred as a result of corporate restructures as well as a result of the establishment of quasi / non-traditional REITs which provide investors with exposure to storage facilities (for example, Iron Mountain and National Storage) data centres (for example, Australia Pacific Data Centres), healthcare property assets (for example, Generation Healthcare) and petrol stations (for example VIVA Energy).

While investor interest in certain REIT offerings may have peaked, we expect to see continued demand in the specialist REIT sector (for example, health REITs) over the next 12 months as investors seek to obtain exposure to high quality assets which have attractive yields which they are not able to access through direct investment.

**"While investor interest in certain REIT offerings may have peaked, we expect to see continued demand in the specialist REIT sector over the next 12 months."**

## 5. Proposed tax law changes to stapled structures and REITs

Notwithstanding the observations earlier, the proposed reforms to the taxation stapled securities in which REITs are commonly structured will affect their use going forward. Broadly, the availability of the concessional managed investment trust (MIT) withholding rate of 15% for distributions to non-resident investors may not be available for those REITs in which active business income of a stapled operating company (which would otherwise be taxed at the corporate tax rate) is converted into passive rental income derived by the stapled MIT which owns the land the business is carried on.

Under the proposed reforms, a stapled structure should only be able to benefit from the concessionary MIT withholding tax where the operating entity is undertaking a business that derives rental income from third parties.

There are complex transitional measures applicable to existing stapled structures, which are broadly dependent on whether the stapled structures holds non-economic infrastructure assets or economic infrastructure assets (i.e. certain infrastructure assets that are used for public purposes).

Given ATO guidance and the proposed changes to the taxation of stapled structures, it is clear any secondary market transactions which seek to retain the stapled security structure are likely to be subject to scrutiny, particularly where the transaction is subject to the Foreign Investment Review Board (FIRB) application process. Accordingly, careful consideration and due diligence should be undertaken in connection with the acquisition of a REIT featuring stapled securities in the secondary market.

## 6. The popularity of dual tracks to continue

We expect to see continued popularity with dual track processes as these processes are more likely to elicit greater strategic tension and therefore more optimal financial outcomes. They can also act as a real hedge against any unforeseen downturn in capital markets.

We also consider that companies undertaking a demerger will give thought to running a dual track process, particularly given the strong demand coming from cashed-up private equity funds.

## 7. Investors to continue to fund M&A

Mergers and acquisitions activity is booming. In fact the first six months of 2018 saw \$2.5 trillion of global M&A deals (which represents a record amount for the first six months of a year). But valuations in certain sectors are now stretched, and although interest rates are still low, they are heading higher. What this means is that this M&A bull market could now be entering a final phase, that is characterised by desires to execute increasingly ambitious deals before the cycle ends. With this current M&A cycle having yet to reach the levels of exuberance seen in early 2000 and late 2007, history would suggest that deal-making sentiments have not peaked yet!

**"The first six months of 2018 saw \$2.5 trillion of global M&A deals - a record amount for the first six months of a year"**

# PREDICTIONS FOR FY19

## 8. Global appetite for buy-backs rises – will Australia follow suit?

The global equity market is shrinking at the fastest pace in decades, as a wave of buy-backs is outpacing the amount of equity being raised (whether by way of IPO or secondary raising). In particular, US companies have been aggressive in this space, largely as a result of the earnings boost delivered by tax cuts and the robust US economy. With investment banks forecasting that the overall volume of US buybacks will reach a record-breaking \$1 trillion in 2018, we consider that buy-back phenomenon may take hold in the Australian market over the next 12 months. We see the theme also playing a part through certain sectors of the Australian equity market over the coming 12 months.

## 9. Tax – the future foretold

### Recent tax reforms

FY18 has been a year of a significant tax reform both globally and in Australia. Australia has been a leading adopter of the numerous measures recommended by the Organisation for Economic Cooperation and Development's (OECD) as part of the Base Erosion and Profit Shifting (BEPS) project. The impact of these amendments on global and domestic capital markets are as yet to be fully observed.

In addition to these reforms, the United States of America has lowered their Federal corporate income tax rate dramatically from 35% to 21% which, as expected, will modify the behaviour of US corporate investors. Critically, the decrease in the US corporate tax rate has resulted in a greater focus from the ATO on the transfer pricing arrangements for related party services and debt between US and Australian entities.

Domestically, Australia has implemented the Hybrid Mismatch rules to reform the treatment of hybrid instruments. The objective of the Hybrid Mismatch rules is to prevent multinational companies from gaining an unfair competitive advantage by avoiding tax or obtaining double tax benefits through hybrid mismatch arrangements which result in asymmetric taxation outcomes. As a result of the Hybrid Mismatch rules, it has become more problematic to implement hybrid instruments as a means of structuring and financing capital markets transactions.

### Important tax cases for foreign investors

The decisions in the following two cases which will likely be handed down in the coming months are likely to impact the tax consequences for foreign investors exiting an Australian investment.

### Case Study:

## Resource Capital Fund IV LP v Commissioner of Taxation

The RCF Case is expected to provide further guidance on how foreign limited partnerships (which are otherwise taxed as companies under Australian tax law) and limited partners (particularly those resident in a treaty jurisdiction) are to be taxed going forward. The case has had a long history and it would seem that both investors and the ATO require clarity on the position at law. Foreign investors structured into Australia should, in the interim continue to consider whether the ATO's concessional treatment is available, and if so, seek to liaise with the ATO prior to any exit to secure certainty.

### Case Study:

## Placer Dome Inc v Commissioner of State Revenue

The Placer Dome case involves important principles regarding how Australian land rich entities and the assets of these entities are to be valued. Although a stamp duty case, the approaches to valuation have a significant application in determining whether shares in company are taxable Australian property for capital gains tax (CGT) purposes and therefore any gains made by foreign residents on the sale of the shares are subject to Australian income tax.

On 5 December 2018, the High Court held that the "top down" valuation methodology adopted by the Commissioner of State Revenue was reasonable in determining whether a company was land rich. This valuation methodology could potentially be adopted by the ATO in valuing assets for taxable Australian property purposes. It remains to be seen what the ATO's views are on the impact of a case which was directed to specific (and now repealed) stamp duty legislation, particularly in relation to goodwill. This has consequences both for vendors and purchasers alike in terms of exposure to Australian taxation on exit for non-residents and compliance with non-resident vendor CGT withholding rules for purchasers.

In carrying out valuations, it is clear from the High Court decision that specific instructions for particular legislative circumstances should be provided to the valuers to ensure that the findings of any valuation can withstand scrutiny from either the ATO or any other revenue authority.

# SECTORS TO WATCH

The following areas are likely to remain sector hotspots into FY19:



Healthcare



Resources



Agribusiness



Technology



Financial Services  
(including fintech)

Given the continuing trend of the Australian economy being bifurcated along broad lines such as health, commercial and financial services (in the services economy) and the continuing major pipeline of players in energy and resources and agribusiness (in the commodities economy), we expect to see most or all of these areas being dominant in both the IPO and secondary (entitlement / placement) markets. This has played out across Australian equity capital markets during the

year and we expect this to continue for the foreseeable future.

In respect of the broader health sector, we see this as continuing to evolve and diversify capturing transactions from the large physical healthcare players (eg hospital and diagnostic players), through to the middle market (medical service roll ups) as well as the continuation of a relatively steady stream of drug discovery and medical device IPOs.

The broader category of commercial

and financial services will be expected to provide a pipeline of capital market transactions at IPO and secondary levels whether as part of a dual track strategy or straight to IPO transactions.

The intergenerational ownership and wealth transfer that Australia is presently undergoing will continue to see the number of private and family owned businesses strongly considering capital markets transactions as a means of either growing and diversifying their

businesses or providing a future pathway to sell down and/or exit.

Similarly, energy and resources cannot be discounted as an underlying driver of capital markets based on the secondary market activity during the year.

Finally, we expect to see a continuing small but steady stream of foreign – listed companies seeking to raise capital in Australian markets, whether businesses from our Asian neighbouring counties or, for

example, from United States, Israeli (especially in technology) or New Zealand companies which have also made a steady stream of enquiries to examine the feasibility of entry into the Australian capital markets.

Off shore entrants will need to be mindful of the challenges posed by the Financial Services Royal Commission (refer page 11), however those who can demonstrate the right business model and approach to regulatory issues are likely to find opportunities.



# SPOTLIGHT ON HONG KONG AND SINGAPORE EQUITY CAPITAL MARKETS



## Singapore

In the first half of 2018, some planned IPOs on the Singapore Stock Exchange (SGX) were shelved due to pricing and market volatility. However, listings overall continued at a steady pace including the listing of Sasseur REIT, the first “outlet mall” REIT to be listed in Asia and Koufu Group Limited, a Singapore-grown operator and manager of food and beverage establishments.

The SGX also rolled out several initiatives in 2018 to boost its competitiveness, including:

- Introducing a primary listing framework for the listing of companies with a dual-class share structure (i.e., a share structure that gives certain shareholders, including founders, voting rights disproportionate to their shareholding) to attract high growth companies led by founder-entrepreneurs;
- Updating the listing rules for mineral oil and gas companies so that they remain aligned with industry developments and to facilitate early-stage companies listing on the SGX.

## Hong Kong

In April 2018, The Stock Exchange of Hong Kong Limited (SEHK) amended the Rules Governing the Listing of Securities on the SEHK (Main Board Listing Rules) with an aim to attract well-established high growth companies from emerging and innovative sectors to list on the Main Board of the SEHK. Such amendments:

- permit listings of biotech issuers that do not meet any of the financial eligibility tests under the Main Board Listing Rules;
- permit listings of high growth and innovative companies with a weighted voting right (WVR) structure; and
- establish a new concessionary route for Greater China and international companies with primary listing on a qualifying exchange to apply for a secondary listing in Hong Kong.

Since the introduction of these amendments to the Main Board Listing Rules in April 2018, the market reaction to the new listing regime has been very positive. A company with a WVR structure and several biotech companies have already obtained listing in Hong Kong. A number of biotech companies have submitted or are considering submitting their listing applications under the new regime. Ascleitis Pharma Inc., a Chinese biotechnology company, was the first biotech company to list in Hong Kong, and raised approximately HK\$3.14 billion (equivalent to approximately US\$400 million) in its IPO. Xiaomi Corporation, Chinese smartphone giant, became the first company with a WVR structure to list in Hong Kong, and raised approximately HK\$37 billion (equivalent to approximately US\$4.7 billion) in its IPO. Apart from the above highlighted listings which came about under the new regime, there were several high profile listings in 2018, including the listing of China Tower Corporation Limited, which was the world’s largest IPO in two years. China Tower, the world’s largest telecommunications tower infrastructure service provider, raised approximately HK\$54 billion (equivalent to approximately US\$6.9 billion) in its IPO.