M&A 2020 Outlook

Public M&A Trends for 2020

CORRS CHAMBERS WESTGARTH

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Deal predictions based on real data

We look beyond statistics to consider what strategies and drivers really matter to bidders, targets and shareholders undertaking a public M&A deal in 2020.

This report is based on the most recent data taken from our proprietary database and in-depth research for the 12-month period ended 30 September 2019.

Contents

“Whenever there is change, and whenever there is uncertainty, there is opportunity.”

Mark Cuban,
American businessman
and investor

1 Introduction

In the current global market, very few things are certain, other than that volatility and change are ever-present. What then does this mean for the short to medium-term outlook for public M&A?

In this year's M&A Outlook, we set out our views on what 2020 is likely to bring in the world of public M&A, based on our experience acting on transactions over the last 12 months, our analysis of the latest available data and our discussions with leading industry players.

The last year has been a relatively strong one for public M&A. Deal numbers and average deal values were broadly consistent with prior years (other than in 2018, where there was an unusually sharp spike in activity). More significantly, we observed much more competition and complexity in the deals that were announced.

Two fundamental trends emerged in the past 12 months, which we expect will continue into 2020.

First, there are strong drivers for increasing competition and complexity in deals.

In a world of low underlying economic growth, businesses are becoming increasingly ambitious and creative in the ways they look to M&A to drive inorganic growth.

At the same time, there is more private capital—particularly in private equity funds—to deploy than ever before. Private equity was much more active in public markets this year, driven by the need to find large targets to deploy the amount of capital that has been raised.

However, it is not just private equity that is looking to deploy capital. We observed superannuation and pension funds, and other financial investors join together with private equity and strategic bidders to deploy capital directly themselves.

We see private capital as a key driver of deal trends next year and expect that this will drive competition and complexity in deals.

While low interest rates and the hunt for yield mean that equity markets will continue to move upwards, making some deals harder to do in the short term, we believe that bidders will ultimately end up getting deals done at a higher price, both because of the level of competition for good opportunities and because the low interest rate environment will become the 'new normal'.

Second, regulators will continue to be more active and interventionist than before.

We saw changes in policy and a step-change in enforcement from all relevant regulators, including the Foreign Investment Review Board (**FIRB**), Australian Securities Exchange (**ASX**), Australian Securities and Investment Commission (**ASIC**) and Australian Competition and Consumer Commission (**ACCC**). These regulators have adopted a more interventionist approach to transactions in a 'post-banking royal commission world'. Their key areas of focus are regulating access to data, with both FIRB and the ACCC identifying this as a priority, and ensuring that there is a level playing field for transactions by promoting competition and limiting the scope for unequal treatment and improper influence.

While we expect more competition, complexity and creativity in the way deals are executed, at the same time and somewhat counter to this, we also anticipate that regulators will scrutinise the way in which those deals get done more closely than ever. Investor expectations in relation to environmental and social governance matters, including climate change, modern slavery and human rights, will also influence the M&A landscape.

What this means for target and bidder boards and investment committees is that they (and their advisers) will need to take a holistic approach to M&A deals. This will be necessary in order to carefully navigate the fine line between getting a deal done which is commercial and competitive, while also satisfying all of their internal stakeholders, the interests of their counterparties and the evolving policies of regulators.

Corrs M&A Team

2 Key trends and predictions for 2020

What we expect we will see next year

MORE COMPLEX, CREATIVE, DIFFICULT DEALS

Bidders have more capital to deploy, business wants to grow by acquisition, but targets have higher price expectations

MUCH MORE REGULATORY SCRUTINY

Regulators want to be seen to be more active in a post-Banking Royal Commission environment

Who will be targets?

1. We will continue to see less resources activity

While still accounting for the largest proportion of deals in the last 12 months, we are seeing a decrease in activity in the energy and resources sector. We expect this trend to continue, with a relatively higher level of activity in healthcare, software, property and telecommunications, fuelled by changes in technology and interest from private equity in these particular sectors.

2. Increased competition for assets

Given the fundamental drivers for M&A are strong, we are seeing healthy competition for attractive assets (four targets were the subject of competing bids in the last 12 months). As economic growth remains generally low, greater interest will be focused on those few businesses that present attractive opportunities. Targets are also getting much better at running competitive processes for public assets.

3. More demergers

As valuations make deals difficult to do, we expect to see more demergers as an alternative to create value, particularly following the success of Coles, Domain and the proposed Graincorp malt demergers. This will create more competitive tension for deals and potentially generate further activity as the demerged entities will be more attractive targets.

Who will be bidding?

1. There will be more activity from private equity and super funds

Private equity bidders accounted for more bids by number and percentage in the last two years than in any year since we started reviewing data in 2011. AustralianSuper used its shareholding on two deals this year to roll-over and support a private equity consortium rather than sell. This approach will continue to drive activity.

2. Foreign interest (ex China) will remain high

This continues a trend we saw over the last 12 months with foreign bids accounting for 48.94% of bids and 64.4% by value (so more bigger deals) but far less from China (only 1 out of 23 compared with more than 30% in previous years).

3. Major shareholders will be critical

Bidders have to be focused on how to structure deals around major shareholders. Shareholders played a significant strategic role in a number of transactions and we saw more than 48.9% had pre-bid interest over the last 12 months. Bidders need to carefully consider how to approach major shareholders. Bidders are also more likely to acquire a direct stake than ever before.

How will they pay?

1. Lower premia except for foreign bidders

We expect premia to remain slightly down when compared to previous years (33.41% in the last 12 months). This is consistent with a general increase in equity markets as yields remain low. However, foreign bidders are still paying much more at 44.21% compared to 24.31% for domestic bidders. This is assisted by their exchange rate advantage, and also potentially reflects the desire by targets for higher premia when more regulatory risk is involved.

2. Cash will remain king but scrip set to increase

Cash is still most popular (with 61.70% of transactions offering cash only), which is not surprising given low interest rates and also the high percentage of foreign bidders. However, we did see a significant increase in scrip-only consideration (23.4% of transactions) and think this will continue as equity markets stay strong and more listed bidders take the opportunity to use their highly valued scrip as consideration.

3. Roll over consideration structures

Given the importance of major shareholders and management to executing transactions, we expect bidders to continue to look for ways to give those parties equity as part of the structure. We expect to see different structures used as regulators continue to focus on 'stub equity' structures next year.

How will it get done?

1. Bridging the value gap using creativity and timeliness

Even though there are strong drivers for activity in public M&A, low interest rates mean that equity markets will continue to move higher, making some deals harder to do in the short term. We expect that more creative structures will be used to bridge this gap and bidders will need to move quickly in order to avoid their premium being eroded with time.

2. Greater use of process deeds

We saw more deals with 'process deeds' agreed before due diligence than in any year since 2011. This is only going to continue as more bidders understand the benefits they can offer, including the certainty of a recommendation and exclusivity before diligence, and insist on them as a condition of progressing any deal.

3. Greater use of warranty and indemnity insurance

W&I insurance is now becoming increasingly common in public M&A, even on large and significant deals such as BGH's bid for Navitas. Its use has been limited to date by bidders being reluctant to propose it in competitive situations or when seeking a recommendation, but we expect to see a lot more of this in 2020.

What will the regulators do?

1. Data focus for regulators (and bidders)

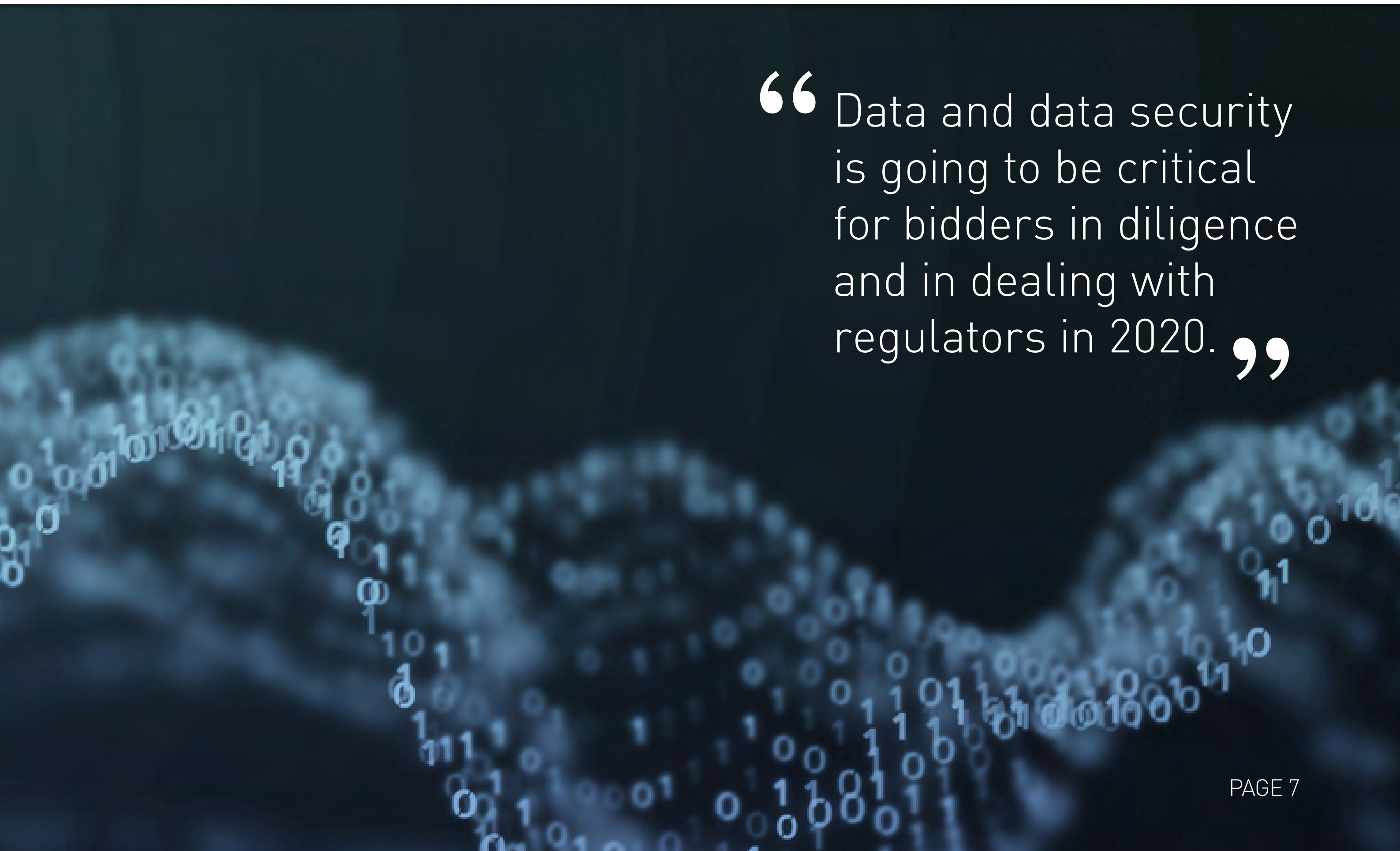
Data and data security is going to be critical for bidders in diligence and in dealing with regulators in 2020. FIRB has already called it out, stating that it treats sensitive data as being akin to 'critical infrastructure', and the ACCC is increasingly focusing on it as an area of competitive importance through network effects.

2. More intervention

As a general comment, we see more regulatory intervention ahead in 2020, including from FIRB, ASIC, the ACCC and the Takeovers Panel. Even if regulators do not oppose deals, bidders and targets should be prepared for more scrutiny on their transactions over longer periods, and will need to factor this into timetables and carefully weigh up the relative regulatory risk of deals (especially in competitive situations).

3. Level playing field

ASIC and others are focused on ensuring that shareholders and bidders are treated equally, whether in the context of voting on schemes, stub equity structures, or ensuring targets are not unfairly locked up, including through pre-bid structures and voting intention statements. We expect to see this focus continue, with new guidance on truth in takeovers statements due out from ASIC this year.



"Data and data security is going to be critical for bidders in diligence and in dealing with regulators in 2020."

3 What happened?

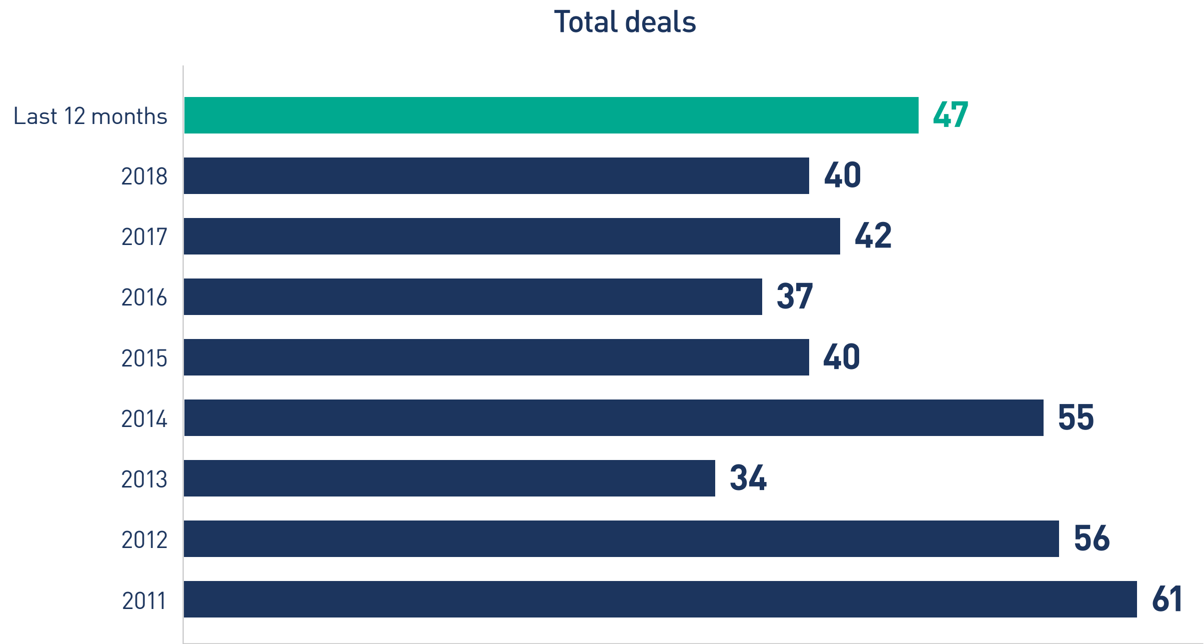
A snapshot of public M&A activity including deal structure, bidders and targets

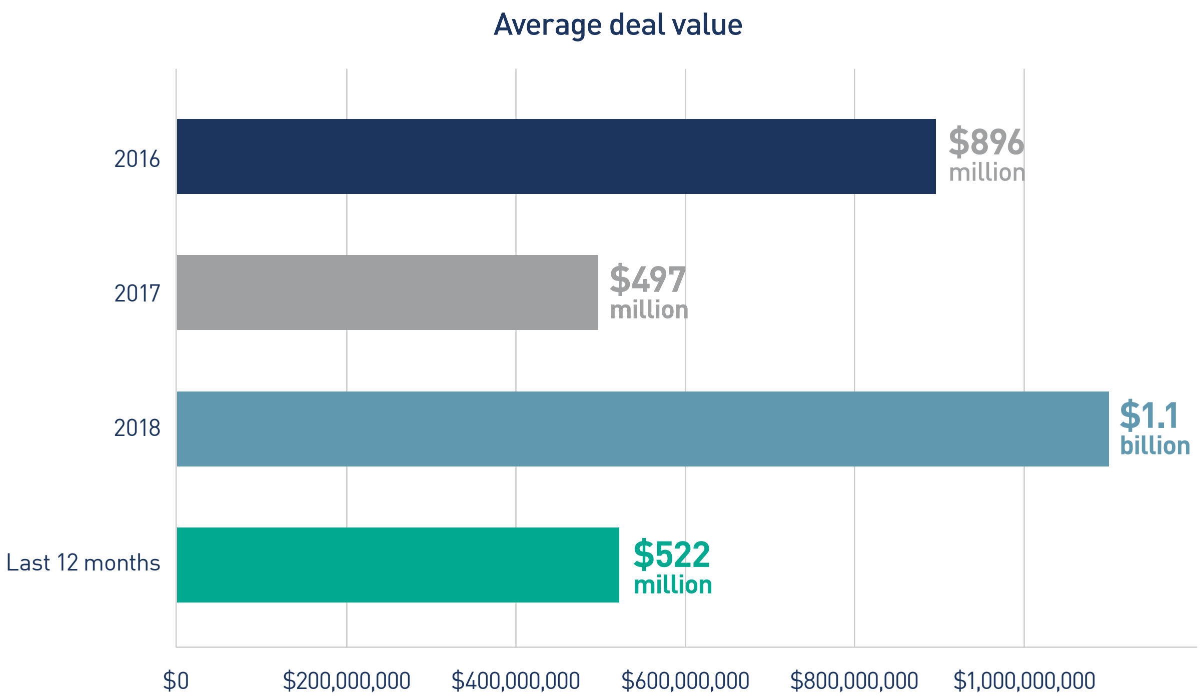
3.1 Overview of activity

There were good signs of strength in public M&A markets over the past 12 months, in particular:

- The number of deals was consistent with, and actually slightly greater than, what we have seen since 2014
- The average deal value of A$522 million was lower than 2018, but slightly higher than 2017
- There were six deals with transaction values above A$1 billion – two less than in 2018 but more than 2017

This momentum bodes well for a strong year of M&A activity ahead.


Total deals
Last 12 months
2018
2017
2016
2015
2014
2013
2012
2011
47
40
42
37
40
55
34
56
61


Average deal value
2016
2017
2018
Last 12 months
$896 million
$497 million
$1.1 billion
$522 million
$0
$200,000,000
$400,000,000
$600,000,000
$800,000,000
$1,000,000,000

3.2 Transaction structure

Schemes of arrangement continued to be the most popular form of transaction structure. The key benefits, including certainty of timing and outcome, continue to be attractive for acquirers.

All of the A$1 billion+ deals were structured by way of scheme of arrangement, with 91% of deals with a transaction value of A$500 million+ proceeding by way of a scheme. Takeover offers were more common at the lower end of the market.

IN FOCUS **BROOKFIELD BID FOR HEALTHSCOPE**

The Brookfield proposal for Healthscope was a novel deal structure designed to overcome the potential for major shareholders to block a scheme of arrangement. Brookfield used a similar but slightly different structure in 2011 in its takeover of Prime Infrastructure.

The deal involved a takeover bid by Brookfield at A$2.40 per share (with a 3.5 cent dividend) together with a concurrent scheme of arrangement proposal offering A$2.50 per share. The two-pronged structure followed an A$2.36 competing offer from a consortium, which included BGH Capital and AustralianSuper, which was a 19% shareholder of Healthscope. AustralianSuper had agreed with BGH Capital not to support competing offers, including the Brookfield proposal.

The higher consideration offered under the scheme can be justified on the basis that, if implemented, Brookfield would have the certainty of acquiring 100% of Healthscope and therefore have all of the benefits of 100% ownership (i.e. the benefit of tax consolidation, absence of minorities' interest etc.).

However, for the scheme proposal to proceed, it required the support of at least 75% of votes cast at the scheme meeting. Unless Brookfield could overcome the existing shareholder support for the A$2.36 proposal, its proposal was unlikely to receive the requisite support from existing Healthscope shareholders.

The fall back (which would only proceed if the scheme failed) was the takeover proposal. Importantly, the takeover bid was subject only to a 50.1% minimum acceptance condition. This meant that if a majority of Healthscope shareholders accepted, the deal would proceed regardless of whether the existing 19% shareholder (being AustralianSuper) accepted, thus potentially leaving that shareholder as a minority shareholder with a relatively illiquid investment if it did not accept. The ability of this structure to proceed without the support of the 19% shareholder would have put significant pressure on the shareholder to vote in favour of the scheme.

In the end, the rival bid consortium abandoned its proposal, leaving the 19% shareholder of Healthscope free to support the Brookfield scheme proposal and receive the higher offer price.

3.3 Identity of bidders

Foreign bidders were once again active in Australian public M&A markets, representing 48.9% of all bidders, and 54.5% of bidders for deals with a value of A$500 million or above.

Interestingly, there was a significant drop in the number of Chinese bidders, with only one Chinese/Hong Kong bidder (the Gindalbie Metals scheme) out of a total of 23 foreign bidders.[1] This is a noticeable shift compared to the position five years ago where Chinese/Hong Kong bidders made up around 30% of all foreign bidders. With the tumbling yuan, unrest in Hong Kong and continuing scrutiny of inbound investment by Chinese entities, we expect to see this trend continue into the foreseeable future.

Bidders came from a range of different jurisdictions with no particular jurisdiction being materially more common than any other. In addition to a decrease in bidders from China, we also noticed a decrease in the proportion of bidders coming from Europe, which had made a relatively large contribution to public M&A bids in the year prior.

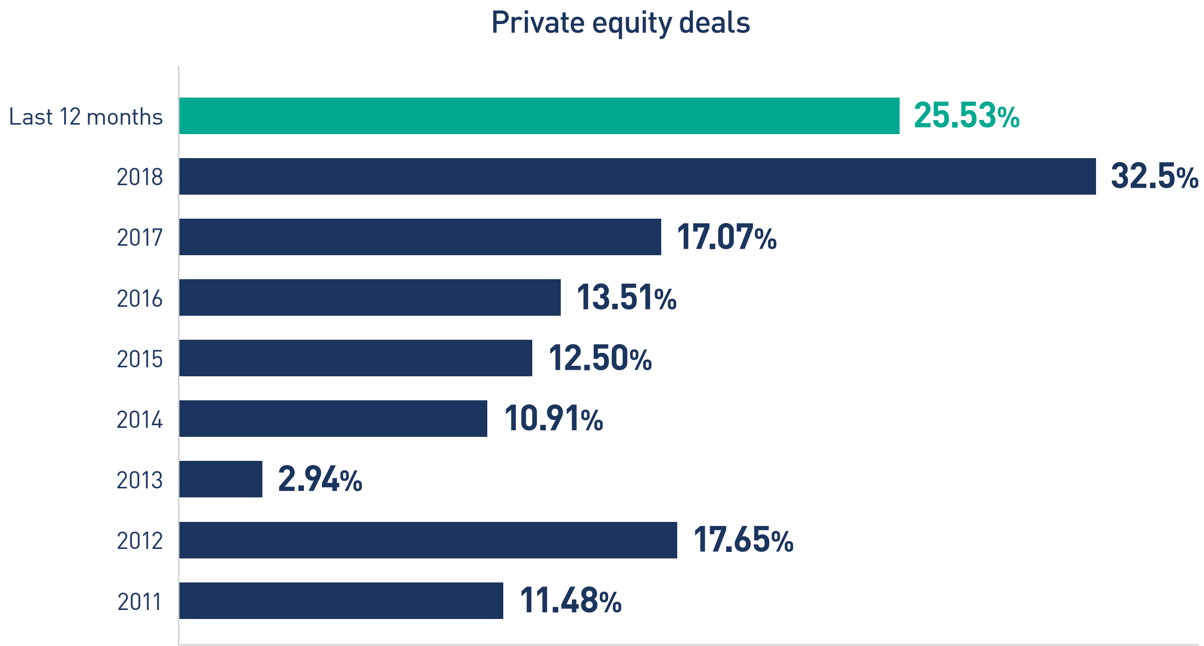
> “In addition to a decrease in bidders from China, we also noticed a decrease in the proportion of bidders coming from Europe.”

1 The consortium, led by China-based alternative asset fund manager CDH Investments, acquired Sirtex Medical Limited by way of a scheme of arrangement in September 2019, however this deal was outside the scope of our research period.

One key trend we saw this year was that private equity firms are back playing in public markets with the largest number and percentage of 'take private' transactions by private equity firms over the last two years since 2011.

New firm BGH Capital was behind two of the biggest private equity-backed proposals, including the initial proposal for Healthscope referred to earlier, as well as an A$2.1 billion play for education group Navitas. We also saw KKR make a successful bid for MYOB.

Having seen the continuation in borrower-friendly economic conditions, together with the record amounts of capital raised by private equity funds in the last few years (which is difficult to deploy in private markets alone), we expect to see a continued increase in the level of private equity activity in public markets over the coming years.



3.4 Target industries

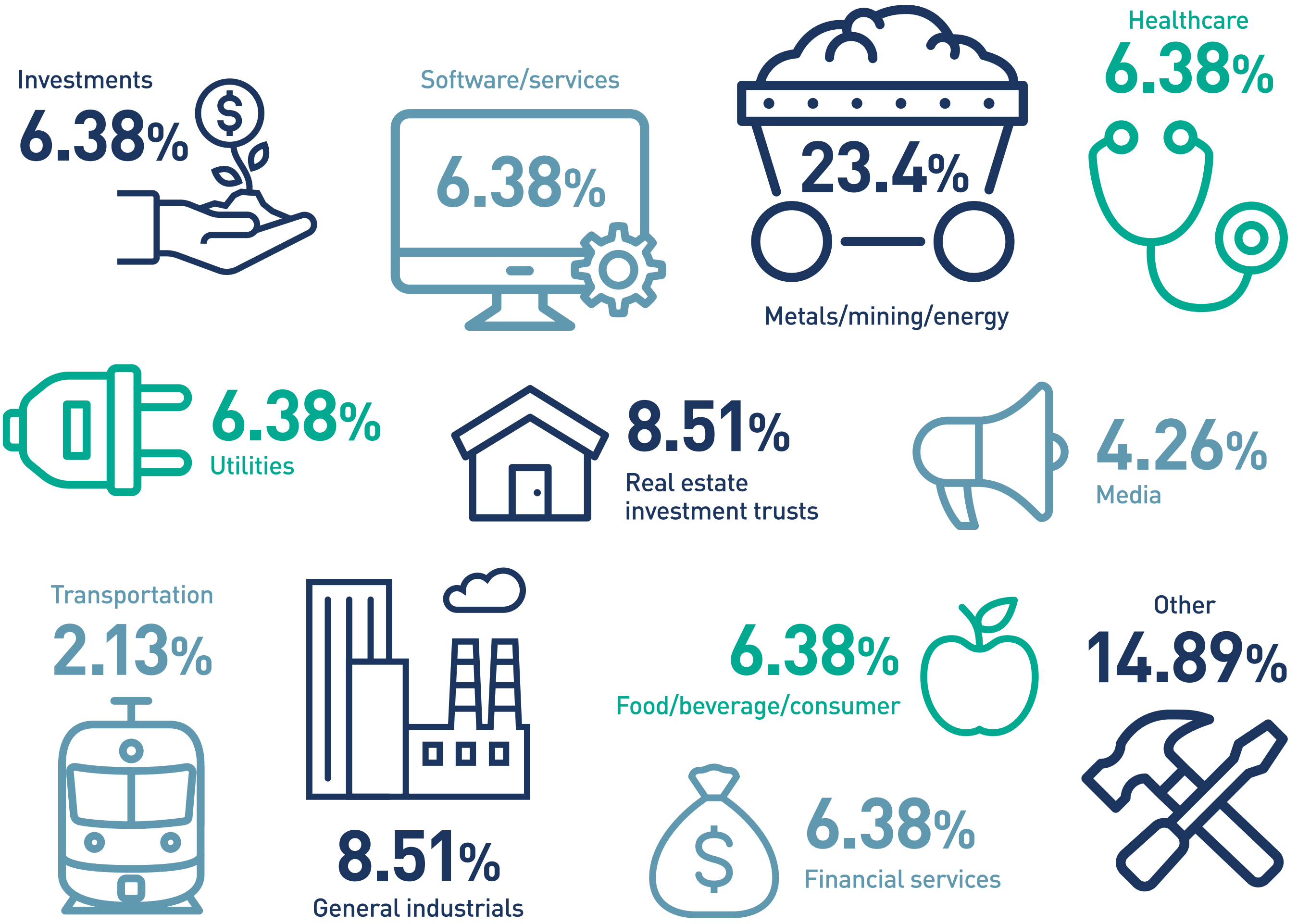
The resources sector was the most active industry sector for public M&A activity in Australia in the past 12 months, although activity was lower in relative terms than it has been in previous years.

Deals in the metals and mining and energy sectors represented 23.4% of deals (by volume). Average deal values in these sectors (A$394.1 million) also trended up from prior years.

Outside of resources, deals were well spread across the real estate, financial services, software, consumer, general industrial, utilities and healthcare industries. Continuing on the strong level of activity seen in the software sector, the acquisition of MYOB was the largest transaction (by value) announced in the sector, with a transaction value of A$2 billion. We did not see the same level of excitement around the engineering services and agricultural sectors as we have seen in recent years.

The largest deals during the period by value were well spread across software (MYOB), healthcare (Healthscope), property (Aveo Group), education (Navitas), materials (Dulux) and consumer (Bellamy's) sectors.

Deals by industry sector



IN FOCUS THE RESOURCE INDUSTRY – OUR LAND ABOUNDS IN NATURE'S GIFTS

Activity in the resources industry has dominated the Australian public M&A market for as long as most of us can remember.

Unsurprisingly, given ongoing global uncertainty (US and China free trade concerns, Brexit, Iran and North Korea etc.), gold sector deals dominated the statistics, making up 70% of all resource sector deals. The recent mega-mergers of Barrick and Randgold and Newmont and GoldCorp are expected to drive a wave of further mid-tier consolidation. The highest value deal in the resources sector, however, was Wesfarmers' acquisition of Kidman Resources in the battery metals sector, which completed in September 2019.

The energy sector was quieter than we would otherwise expect given a stronger oil price environment.

This was no doubt partly due to the dearth of mid-tier energy companies left on the ASX following the takeovers of companies like AWE Energy and Sino Gas & Energy in early 2018. The unsuccessful attempt to acquire Stanmore Coal (A$239 million) was the only deal in the coal sector.

There has also been substantial transactional activity in the resources sector outside the glare of the public spotlight. Some of the more notable deals included Santos' A$2.15 billion acquisition of Brookfield controlled Quadrant Energy (oil & gas), Abermale's A$1.3 billion acquisition of a 60% share of Mineral Resource's Wodgina project (lithium) and Hancock Prospecting's A$750 million acquisition of private company Riversdale Resources (coal).

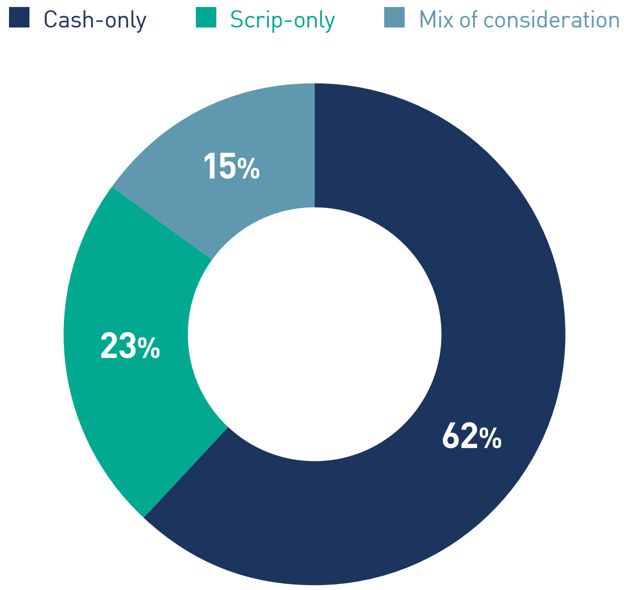
4 How did they pay?

Consideration structures, control premia and funding

4.1 Form of consideration (cash is still king)

Cash continued to be the most common form of consideration offered (61.7% were cash-only deals), although we saw a significant increase in deals with scrip-only consideration (23.4%).

Consideration



This is consistent with an environment where target (and bidder) shareholders are supportive of a strategy of growing inorganically through M&A. Deals are able to be sold on the basis that they are value accretive and able to deliver a merged entity that is greater in value than its parts through cost, revenue and other synergies.

Dividends remain a common mechanism to bridge value gaps. We saw around 28% of deals allowing the payment of a dividend to target shareholders and two deals allowing payment of a special dividend that was funded by the bidder. Special dividends continue to be a useful means of bridging a value gap where the associated accounting and tax issues can be properly managed, however they were not as common this year as we have seen in previous years.

Special dividends were used in both the Greencross and Healthscope transactions, with the Healthscope dividend also funded by an associated property divestment transaction.

A number of recent deals (Healthscope, Capilano Honey and Greencross) have used the offer of stub equity as a means to provide target shareholders with the opportunity to retain an economic interest in the target, instead of cashing out. Offers of stub equity in transactions have recently come under scrutiny.

4.2 Scrip rollover structures (sticking to the scrip)

A feature of many public-to-private transactions involving private equity is that the private equity bidder will want to incentivise management who remain with the business by giving them equity in the business. The most efficient way to do this will usually be to 'roll over' their existing shares in the target company to shares in the bidder or its holding company, rather than acquiring their existing target shares for cash and subsequently issuing new equity.

In other cases, major shareholders will form part of the bidding consortium and those shareholders will also 'roll over' their shares in the target company as part of the deal.

However, rules applying to takeovers and schemes may mean that difficulties arise in offering a different mix of consideration or the opportunity to 'roll over' only to those specific shareholders. Limiting such an offer to specific shareholders will likely exclude them from the scheme vote. This has the effect of decreasing the size of the stake required to block the deal and also giving those specific shareholders the ability to collectively block the transaction.

It has been interesting to see private equity bidders deal with this issue in a variety of ways. Some used a stub equity structure, where all shareholders are offered the same opportunity to roll over their equity into an unlisted and relatively illiquid investment (e.g. Healthscope, Capilano Honey and Greencross). Others accepted that the shareholders would be excluded and limited the offer to a specific set of shareholders (e.g. Navitas and Scottish Pacific). The decision to look at an alternative structure in Scottish Pacific may have been influenced in part by ASIC's recent criticism of stub equity structures. We think we will continue to see alternative structures being explored by bidders to solve this issue (see ASIC section).

IN FOCUS **STUB EQUITY TAKEOVERS**

The stub equity consideration structures we saw used in the Healthscope, Capilano Honey and Greencross takeovers have recently been the subject of criticism by ASIC due to concerns that retail investors do not have the same disclosure and governance protections that would otherwise apply to an Australian public company.

Stub equity structures allow target shareholders to elect to take up a limited number of shares in the bidder or its holding company, as consideration for the acquisition of their target shares. These structures are not a new feature of the market and are regularly used by private equity acquirers, where the issuer of the stub equity will be a non-listed entity and sometimes a proprietary company. In such cases, target shareholders who choose to take up the stub equity acquire a relatively illiquid security and are usually subject to restrictions on their ability to sell, as well as drag rights which require them to sell into a private equity exit. Those limitations need to be fully disclosed in the transaction documents, so shareholders who take up the stub equity are fully informed about the security they are acquiring.

In response to the Capilano scheme, ASIC published a media release in which it warned the market that transaction structures using proprietary companies as stub equity risked ASIC intervention. In a subsequent consultation paper, ASIC went further, proposing to limit the use of custodian arrangements in connection with the issue of stub equity. The use of custodian structures, however, is a common feature of stub equity structures as it allows the bidder to ensure the number of registered shareholders post transaction will not cross the thresholds at which the takeovers regime and disclosing entity requirements under the Corporations Act 2001 (Cth) kick in.

The use of stub equity structures allows target shareholders, including retail shareholders, to share the benefits of take-private transactions, particularly in circumstances where public capital is becoming increasingly expensive. While true that shareholders who participate in the stub equity accept lower levels of ongoing disclosure as the price of participation, they do so on a fully informed basis.

ASIC is understandably responding to what it perceives to be an erosion of disclosure standards. The risk, however, is that if ASIC's proposals are implemented, private equity will likely turn to structures in which the stub equity is issued by an overseas company outside ASIC's regulatory reach. That can hardly be a good outcome for retail shareholders.

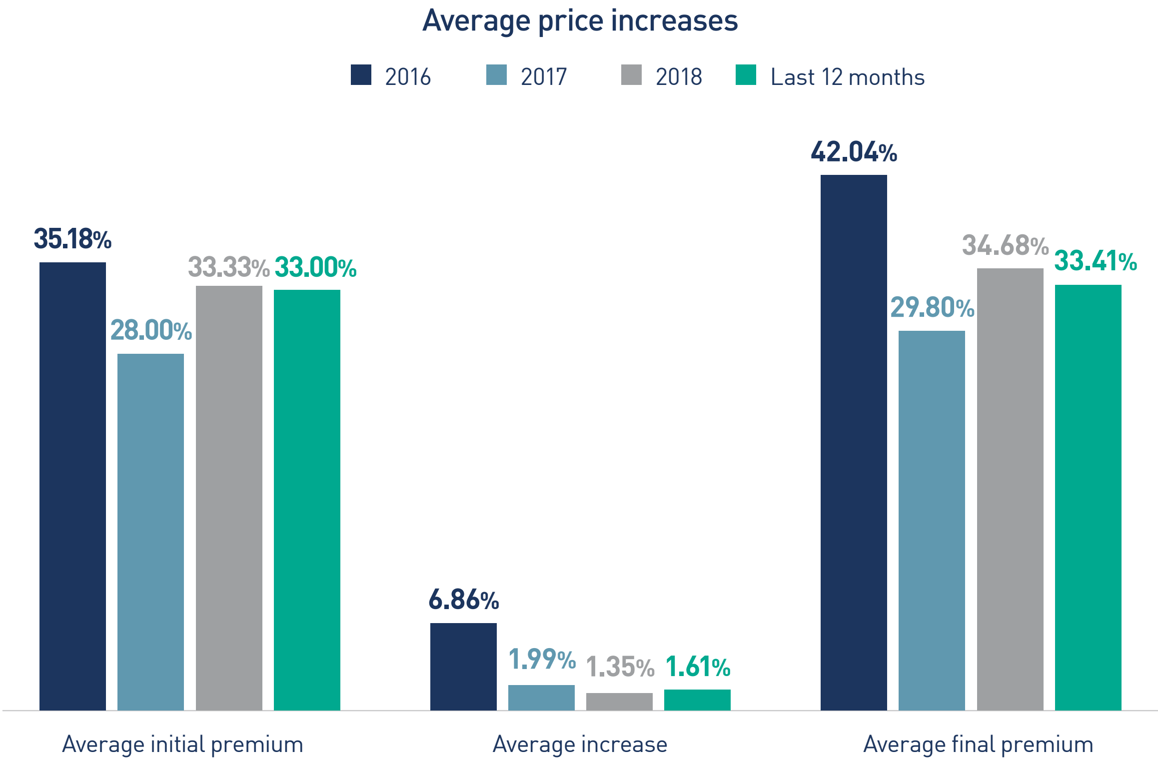
4.3 Control premium and price strategy

The average initial premium offered by bidders in deals in the last 12 months was 33%, which is similar to 2018 but materially higher than the average initial premium of 27.9% in 2017. This suggests initial bids in 2018 and in the last 12 months were more fully priced than in 2017.

Higher initial bid premia may also explain the reason for fewer increases in price in the last 12 months.

In this period, bidders increased their offer price after the deal became public in 12.77% of deals (six out of 47 deals), which is lower than previous years.

On the other hand, the average final average premium for completed deals (33.41%) was slightly lower than in 2018 (34.68%) but materially higher than in 2017 (29.80%).



The average final premium is only marginally higher than the average initial premium in large part because the final premium on KKR's bid for MYOB was lower than its initial premium as a result of a reduction by KKR of the offer price following its completion of due diligence.[2] We expect this was resisted heavily by MYOB and is the reason for the negotiation of an unusual 'go shop' arrangement (see Section 5.3).

The fact there were fewer price increases in this research period is not surprising given that there was slightly less competition in the last 12 months when compared with the previous year. We also saw fewer announcements of a transaction in the last 12 months without a recommendation already having been secured than we did in previous years (see Section 5.5).

2 There was also a small reduction in the offer price paid by Brookfield for Healthscope between its initial offer and its final offer due to the deduction from the offer price of a dividend paid by Healthscope between those dates.

Interestingly, foreign bidders continue to be prepared to pay more for control. Over the last 12 months, the average premium paid by foreign bidders was 41.2%, while an average premium of 24.9% was offered by Australian bidders. This is likely to have been aided in large part by the relative weakness in the Australian dollar and target boards' desire for higher premia.

41.2%

The average premium paid by foreign bidders was 41.2%

24.9%

The average premium offered by Australian bidders was 24.9%

4.4 Funding of cash consideration

Debt funding was common for cash deals, with 51.7% of deals offering some form of cash consideration involving debt finance. This is not surprising given the relatively high incidence of private equity bidders and low cost of debt at present.

It was interesting to see this year that none of the cash deals were funded by an equity raising. However, this is again not surprising given the low cost of debt and high level of volatility in equity markets. We expect that we will see more cash deals funded by equity raisings as equity markets stabilise and listed companies look to use their equity which is priced at all-time highs.

> "It was interesting to see this year that none of the cash deals were funded by an equity raising."

5 How did it get done?

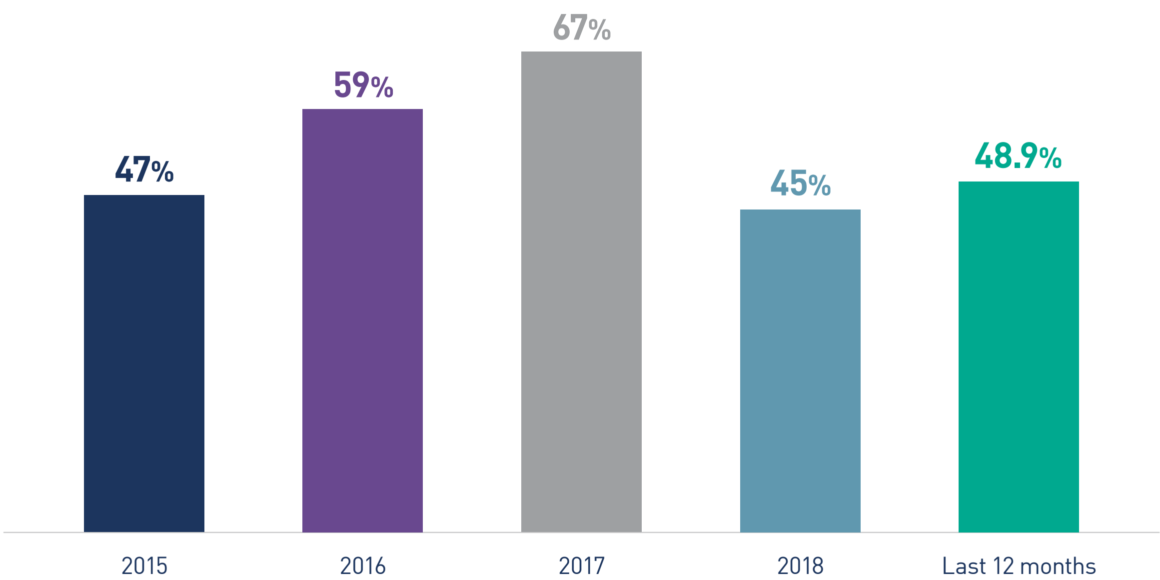
Execution of deals including pre-bid strategy, conditionality, competition and deal protection

5.1 Pre-bid strategy

In our last M&A report, we highlighted a continuing trend towards bidders taking pre-bid stakes, with 67% of bidders having commenced with a pre-bid stake in 2017. This was up from 59% in 2016 and 47% in 2015.

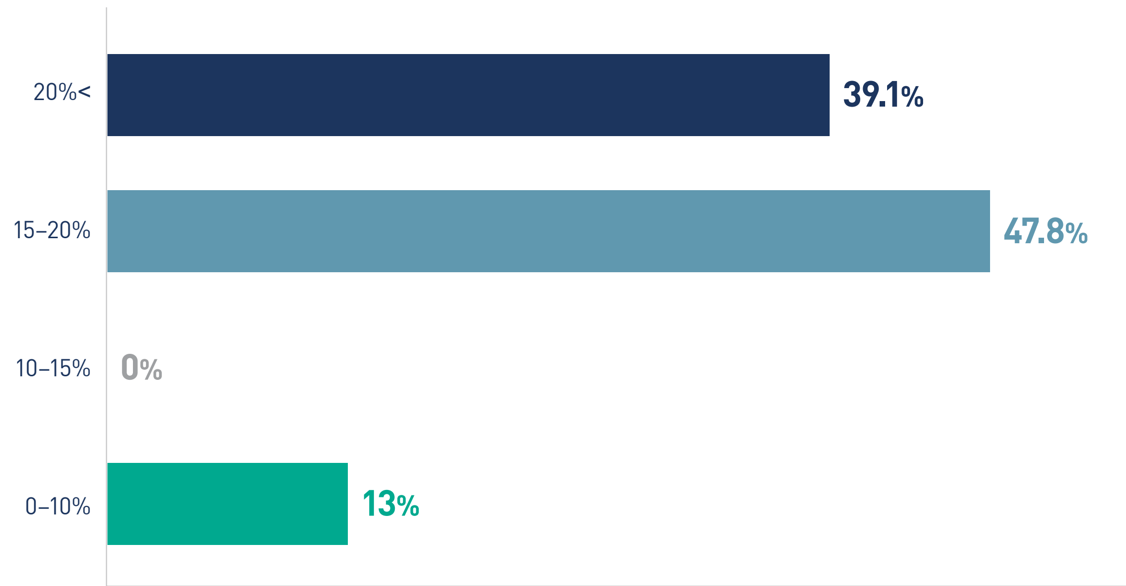
However, since then we have seen a decline in the number of bidders with a pre-bid interest in the target, with only 45% of bidders in 2018 and 48.9% of bidders in the last 12 months falling into this category.

Bidders with pre-bid stake over



The vast majority of the stakes fell within the 15-20% range, with bidders seeking to obtain as large an interest as possible without crossing the 20% threshold which would require them to find an exception to the 20% takeovers prohibition.

Range of pre-bid stakes



There were, notably, three transactions where a bidder had decided to make a second pass at a target and therefore already had a significant stake in the target well in excess of the 20% threshold obtained as a result of the prior takeover attempt. The relevant bidders were Sea Harvest, which had a 56.28% pre-bid interest in Mareterram, and Paladin Energy which made a bid for Summit Resources off the back of an 82.08% holding.

A similar mop-up bid was made by Nine Entertainment for Macquarie Media off the back of Fairfax's pre-existing 54.5% shareholding.

Form of pre-bid interest

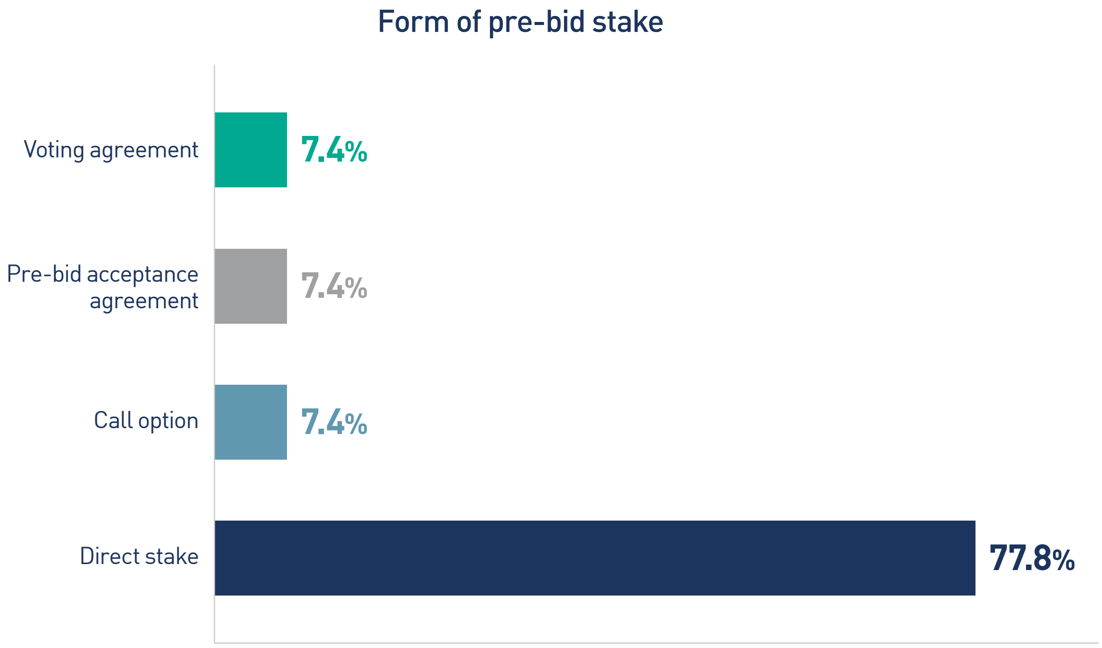
For both takeover bids and schemes, the most common form of pre-bid interest was a direct stake in the target, although there were also examples of call options, pre-bid acceptance agreements and voting agreements.

Voting agreements were more prevalent in the past 12 months when compared to previous years, with three bidders[3] entering into voting agreements with major shareholders. Parties have in the past been reluctant to enter into voting agreements because of a concern that they may lead to the shareholder being excluded from voting with other shareholders.

We think the shift is due to a combination of factors, including:

- a willingness to test whether such arrangements do in fact create a separate scheme class for the purposes of voting;
- where the shareholder has less than 20%, it could be a recognition that ASIC is starting to treat voting intention statements as an 'agreement', and so they are being drafted as such, with only a handful of shareholders making intention statements in the past year; and
- in many cases the relevant shareholders were excluded from voting because they were receiving a different consideration, so scheme class definition was not an issue.

3 This statistic includes the Cooperation and Process Agreement that BGH Capital entered into in respect of Navitas Limited, which imposed on the relevant shareholders and obligation to vote in favour of a scheme proposed by BGH Capital.



Voting or acceptance intention statements have been a common means for shareholders to express their support for an announced transaction. They will sometimes be given in response to an inquiry made by either the target or the bidder.

Once publicly announced, the shareholder is bound by the statement under ASIC's 'truth in takeovers' policy. However, ASIC has recently raised concerns that, to the extent the bidder is involved in the procurement of such statements and their involvement amounts to more than a mere 'canvassing' of the views of the major shareholder, those interactions may evidence an understanding or arrangement that gives the bidder some control over the stake or a 'relevant interest' in the relevant shares. This may be disclosable, depending on the size of the stake or, more significantly, a potential breach of the 20% takeovers prohibition.

Cash settled swaps continue to be used by bidders and other persons to accumulate economic positions in target companies.

For example, KKR used swaps to build a position of 2.3% (below the 5% disclosure threshold) in MYOB without risk of disclosure before later quickly moving to an aggregate 19.90% through the acquisition of part of Bain Capital's stake.

Before making its bid for Propertylink, ESR also used a swap with an option for physical settlement (conditional on obtaining FIRB approval) to successfully accumulate a 19.97% position in Propertylink in an overnight raid. This enabled ESR to build an effective stake of 19.9% without first having to obtain FIRB approval.

However, the use and disclosure of swaps has been the subject of increased regulatory scrutiny from both the Takeovers Panel and ASIC, with proposals to tighten the disclosure requirements and also steps by ASIC taken to unwind positions above 20% (see IN FOCUS: Disclosures of economic interests in listed companies).

Pre-bid interests and deal success

Having a pre-bid stake has a number of advantages, particularly in the case of takeover bids, where it provides momentum and deters rival bidders. However, due to the number of factors that can affect the outcome of a transaction, it can be difficult to draw a direct correlation between pre-bid interests and deal success.

Our research reveals a success rate of 73.3% for deals where the bidder did not hold a pre-bid stake, compared with 94.1% for deals where the bidder did hold a pre-bid stake.

What we do know is that having a pre-bid stake sends a powerful message to the target board about the seriousness of a bidder's intentions and also buys the bidder a seat at the negotiating table. It forces the target board to engage or otherwise provide the catalyst for a deal.

This certainly played out in the three-way tussle for control of Propertylink, where it found itself with two new major shareholders on its register. The presence of these shareholders ultimately led Propertylink to make its own offensive play for the Centuria Industrial REIT, which had the effect of putting itself in play and in turn triggering ESR's bid for Propertylink.

Interestingly, while BGH Capital had reached a pre-bid arrangement with AustralianSuper, those arrangements did not ultimately prevent Brookfield from proceeding with its bid for Healthscope. Market practice continues to show that a higher rival offer will, in many cases, be able to prevail over a blocking stake (particularly where it is held by a financial investor rather than a strategic acquirer).

IN FOCUS **BGH CAPITAL**

With shareholder activism on the rise in Australian M&A markets, bidders are increasingly aware of the need to gauge shareholder sentiment prior to making a takeover offer and have clear strategies for engaging with shareholders. While shareholder pressure is more commonly directed towards bidders (usually with an aim to obtain an increased offer price), bidders who engage effectively with shareholders early in the process can sometimes use shareholder influence to their advantage.

We saw this strategy play out in the BGH Capital-led takeover offer for Navitas announced late 2018, where a consortium comprising BGH Capital, AustralianSuper and former Navitas Chairman and Managing Director, Rodney Jones, made a joint bid for the education provider. BGH Capital secured the support of AustralianSuper and Mr Jones (who held 5.4% and 12.6% of Navitas, respectively) through entry into a Co-operation and Process Agreement just prior to submitting the unsolicited indicative offer to Navitas.

The initial offer of A$5.50 a share (which represented a 25% premium based on a three-month VWAP) was rejected by the Navitas board, which stated that the indicative proposal did not reflect the value implied by Navitas management's strategy and plan.

Rodney Jones sought to put pressure on the Navitas board to grant due diligence at the subsequent AGM, voting against the re-election of Chairman Tracy Horton resulting in the resolution being passed by only a narrow margin.

A revised indicative offer of A$5.825 a share was made in January 2019 and led to Navitas agreeing to provide due diligence access and announcing an intention to recommend, subject to signing a scheme implementation deed. British Columbia Investment Management, Canada Pension Plan Investment Board, (which held 2% of Navitas), Ontario Teachers' Pension Plan Board and Sinspec Investment joined to assist in funding the revised proposal.

In late March 2019, the parties entered into a scheme implementation agreement under which the new consortium agreed to pay the revised consideration of A$5.825 a share. The scheme vote was carried in June 2019 with over 95% of votes cast in favour of the scheme.

IN FOCUS MACQUARIE CAPITAL ACQUIRES 50% STAKE IN INVESTA PLATFORM

Another recent transaction that highlighted the importance of major shareholders to the outcome of public M&A was Macquarie Capital's acquisition of 50% of the Investa Office Management platform from the Investa Commercial Property Fund.[4]

The deal was significant because it was completed at the same time as a number of control proposals were being considered for the ASX-listed Investa Office Fund which was managed by the Investa Office Management platform.

Accordingly, the value of the management rights owned by the Investa Office Management platform was likely in part to depend on the outcome of the control proposals.

Further, the Investa Office Management platform held a significant 19.99% stake in the Investa Office Fund for the benefit of the Investa Commercial Property Fund and the transaction with Macquarie Capital was important in determining how that stake could be voted on any control proposal.

Ultimately, the stake was voted in favour of the Oxford Properties proposal for the Investa Office Fund that successfully completed.

5.2 Conditionality

In contrast to a trend in previous years, bidders are now more willing to proceed with a takeover without a 90% minimum acceptance condition.

This likely reflects the fact that schemes are continuing to become a more common structure where the desired outcome is 100% ownership (particularly for deals with transaction values over A$1 billion). Takeovers are therefore more likely to be used in circumstances where obtaining 100% ownership is not a priority and the bidder is happy to either accept no minimum acceptance condition or a 50.1% minimum condition.

For example, ESR's bid for Propertylink and Brookfield's bid for Healthscope were both subject only to a 50.1% minimum acceptance condition to ensure major shareholders in those targets were not able to block the takeover.

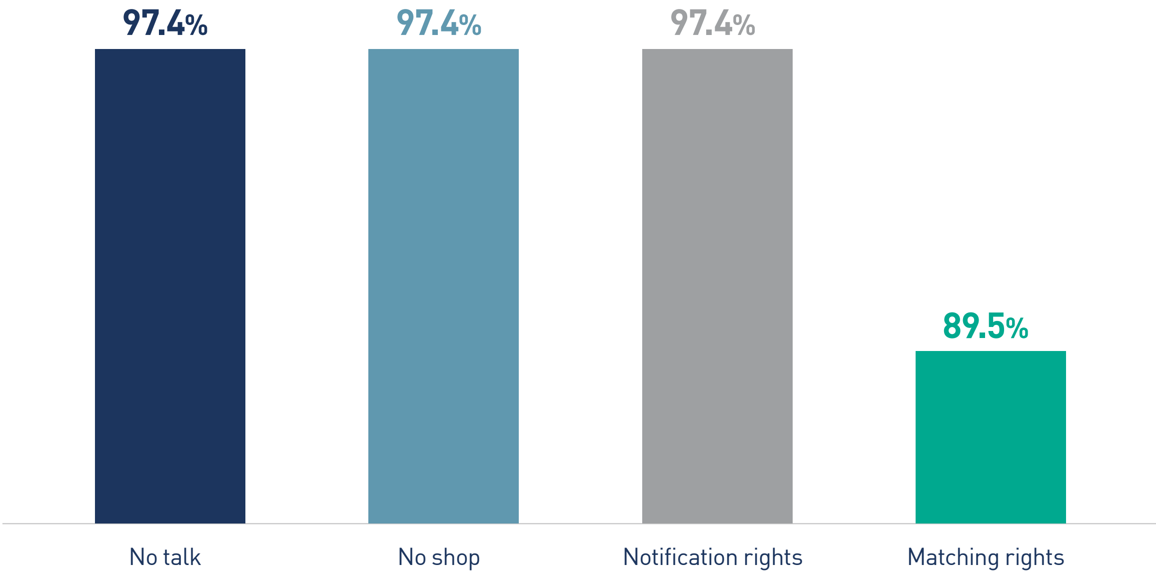
In particular, only 31.3% of deals had a 90% minimum acceptance threshold, in contrast to 54.5% of bids in 2017 (an increase from 32% in 2014). Furthermore, we also saw that only 60% of off-market takeover bids had a minimum acceptance condition of any threshold, which is down on previous years.

4 Corrs advised Macquarie Capital on all aspects of the transaction.

5.3 Deal protection

We continued to see customary deal protection mechanisms as a standard feature of agreed schemes and takeovers in the past 12 months, with 97.4% of such deals including a 'no talk and no shop' restrictions notification and matching rights, and a break fee for the benefit of bidders.

Deal protection in deals with an implementation agreement



In terms of the size of the break fee, we continue to see these largely consistent with the 1% of equity value generally considered by the Takeovers Panel to be a cap on what is acceptable.

To the extent they can, bidders are also looking to bring forward the point in time at which they get the benefit of these types of protections by negotiating a 'process deed' or similar arrangement prior to undertaking diligence, but before reaching final agreement on terms.

On the other hand, takeover targets look to be steadily gaining some ground when it comes to deal protection mechanisms. One recent example of particular note was the use of the very rarely seen 'go shop' provision in the MYOB Group scheme (see IN FOCUS: KKR allows MYOB to 'Go Shop'). More broadly across the market, we are seeing roughly the same proportion of targets insisting on the payment of 'reverse' break fees by bidders. Of the 47 deals with implementation agreements in the last 12 months, 36% included some form of reverse break fee arrangement.

However, a closer analysis shows that bidders are still very much in control when it comes to the likelihood of these reverse break fees becoming payable.

The most common triggers for payment of these fees remain those events which are squarely within the control of the bidder, such as:

- termination of the scheme implementation agreement by the target due to a breach of agreement or breach of warranty by the bidder;
- failure to pay the scheme consideration as required; and
- a change in the bidder directors' recommendation of the scheme.

Ultimately, despite the uptick in the inclusion of reverse break fee structures, bidders are likely to remain resistant to triggers for payment they do not have power over or cannot predict. Examples of such 'uncontrollable' triggers in deals announced in the last 12 months were few and far between, although we did see a small number of bidders agreeing to reverse break fees for events like:

- a material adverse change in respect of the bidder; and
- the bidder failing to satisfy a bid condition such as bidder financing or FIRB approval.

IN FOCUS **KKR ALLOWS MYOB TO 'GO SHOP'**

MYOB negotiated a rare 'go shop' clause as part of its merger agreement with KKR. The go shop allowed MYOB and its advisers to seek alternative proposals for 60 days after the agreement was signed.

As KKR already held 19.9% of MYOB, to make the go shop meaningful, KKR committed to sell its existing 19.9% shareholding into, or vote in favour of, any qualifying superior proposal arising during that period. In addition, MYOB was not liable to pay a break fee within the go shop period for a superior proposal.

A qualifying superior proposal was defined as a cash offer for 100% of MYOB shares that was at least 5% higher than KKR's bid price, which was recommended by a majority of directors and in which there was a binding implementation agreement that had not expired or been terminated.

KKR's proposal withstood the market test, with no qualifying superior proposal emerging within the go shop period. Once the go shop period expired, an exclusivity period commenced, with customary matching rights and non-solicitation mechanisms.

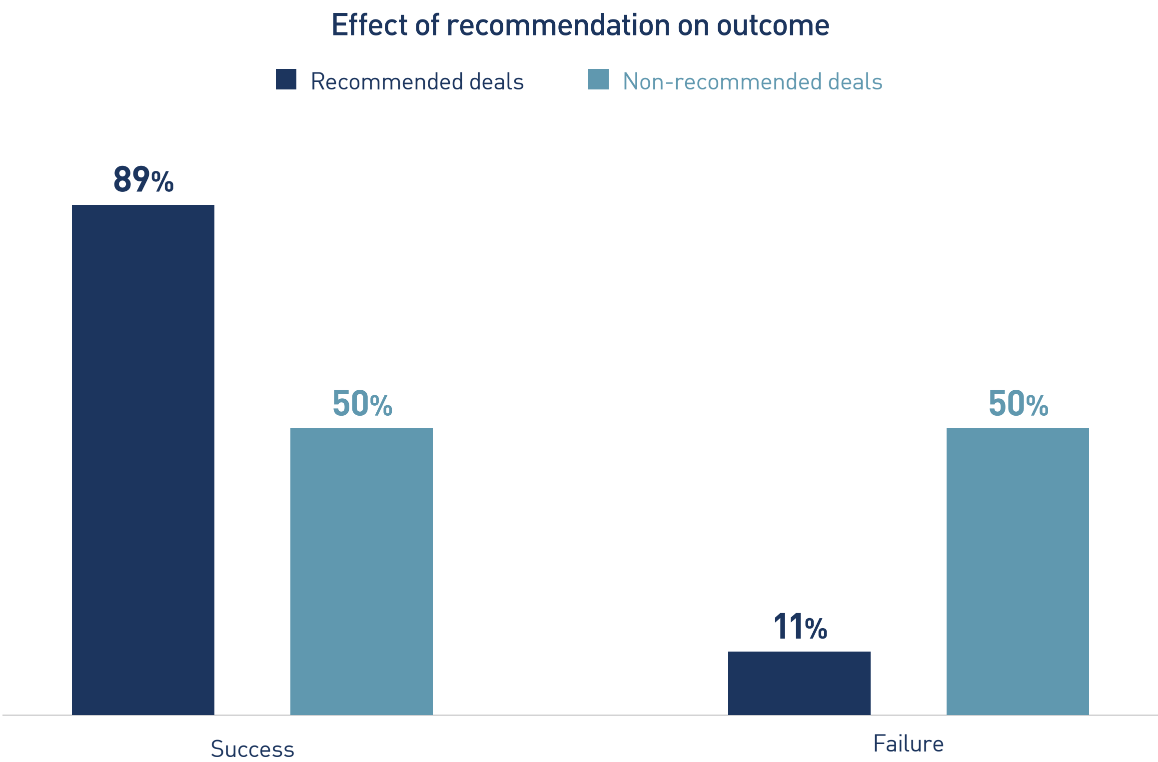
The go shop provisions allowed MYOB to conduct market testing, including initiating or re-initiating contact with a number of strategic parties and financial sponsors. Interested parties were provided with access to information about the company via a management presentation and a data room.

MYOB reported that the justification behind these go shop provisions was to provide shareholders with a level of certainty by enabling MYOB to ensure full and fair market testing, especially given the uncertain market, coupled with the long-term nature of the strategic growth plan MYOB had embarked upon.

> "Bidders are likely to remain resistant to triggers for payment they do not have power over or cannot predict."

5.4 Target board recommendations

Target board recommendations remain the key to the success of public M&A deals. This is by far the factor most closely correlated with the success of deals.



Given that recommendations remain a key point of leverage for target boards, many bidders are now asking that target boards agree, through a form of process deed, to recommend a deal at a given price before the bidder undertakes due diligence and has committed to proceed. Even if a formal process deed is not entered into, in some other instances (such as AVID's bid for Villa World), we are seeing target boards publicly announce an intention to recommend at that price before due diligence.

This development is important for bidders who can otherwise be left in a position where they have negotiated one price to gain access to due diligence only to find that after diligence, the target wants a further increase in order to secure their recommendation.

However, one new development in the making of recommendations by target directors in the last 12 months, is the uncertainty created by recent court decisions about the extent to which directors are conflicted, such that they are not able to make a recommendation.

It is not uncommon to see executive directors and other key employees receive bonus payments or other incentives in connection with a scheme of arrangement. Such incentives typically serve a dual purpose of encouraging retention and recognising the personal efforts of management required to complete the transaction. However, these incentives need to be carefully considered to ensure they do not breach ASX Listing Rules or Corporations Act restrictions on termination benefits.

Despite the prevalence of these arrangements, recent court decisions have called into question whether an executive director receiving this type of benefit should be joining in a board's recommendation of the scheme to shareholders.

Concerns have been raised as to whether it is appropriate for an executive director to make a recommendation to shareholders on how they should vote on a scheme in circumstances where that director stood to receive a substantial benefit if the scheme was approved (e.g. in one case, a cash bonus was almost three times the amount of the director's annual salary).

These concerns have been reflected in recent scheme implementation agreements. In implementation agreements for both the proposed Creso Pharma scheme and the proposed MOD Resources scheme, a fiduciary carve-out was included to the effect of allowing directors to decline to make a recommendation in circumstances where they have an interest in the scheme, such that it would make it inappropriate for them do so.

More recent decisions have expressed a different view, noting that the statutory and regulatory regime will ordinarily require a director to make a recommendation, and shareholders will ordinarily expect a director to do so, even when that director stands to receive a substantial benefit if the scheme is approved.

What remains clear is that, regardless of the approach an interested director takes in deciding whether to make a recommendation, the critical consideration will be ensuring that the nature and extent of the relevant benefit is properly disclosed to shareholders.

5.5 Process deeds reduce uncertainty during diligence

The last year saw a greater number of transactions involving a process / exclusivity agreement as an interim step.

This gives a bidder exclusivity and, in many cases, the certainty of a target board recommendation early, while it is still conducting due diligence and negotiating binding transaction terms. The target will usually leverage an increase in the offer price in return.

In previous years, this has been something seen predominantly in property sector transactions, but in the past 12 months its use has been seen in a number of other sectors, including mining, education and health.

Recent examples include:

- Winfield Group Investments' proposal for Stanmore Coal (announced in early August 2019);
- Blackstone's proposal for Investa Office Fund (announced in May 2018);
- ESR's bid for Propertylink – following an increase in offer value after an initial non-binding proposal;
- BGH Consortium's proposal for Navitas – following an increase in offer value and the bidder agreeing to release certain shareholders from obligations to support its proposal if a superior, unmatched proposal emerged; and
- Brookfield's proposal for Healthscope – following an increase in offer value and in circumstances where there was a less attractive non-binding proposal from a competing consortium.

Customary terms

Typically, these process deeds have included:

- updated (increased) indicative offer terms;
- exclusive access to due diligence;
- obligations to negotiate binding documents in good faith; and
- exclusivity, including 'no shop, no talk' obligations and matching rights.

In many cases, they have included a commitment for the target board to provide a recommendation and in some cases even a break fee - in each case conditional on the parties negotiating binding documents in due course, and certain conduct restrictions such as non-payment of dividends or other distributions.

Periods of exclusivity are generally relatively short, with most of the above examples providing for between two and five weeks to complete due diligence and negotiate binding documents, and the period varying depending on the scope of due diligence yet to be completed.

Strategic benefit

While target boards will generally be able to extract an increase in the offer price in return for entering into such an agreement, we think that bidders will generally benefit more than targets from the negotiation of these arrangements. This is because targets will generally already have the ability to negotiate a higher offer price in return for access to due diligence.

What the bidder gains from the negotiation of a process deed is usually the certainty of getting a board recommendation, without having to increase the offer price further, and exclusivity, while at the same time generally retaining the ability to walk away should it find something adverse in due diligence (subject in many cases to compensating, in some form, the target for their costs).

The risk of a bidder walking away or revising down their offer price after entering into one of these agreements was highlighted last year by KKR's reduction in its offer price for MYOB after its due diligence on the business. However, we believe that targets will generally get comfortable with arrangements on the basis that, despite the agreement being subject to diligence, the recommended offer price will still in many ways set a 'floor' for the deal to proceed.

While we believe these types of arrangements generally benefit bidders more than targets, we expect to continue to see more of them in 2020, given both their increasing use this year and because we think bidders will insist on them as a condition of them progressing a proposal. This will particularly be the case in circumstances where a rival proposal is unlikely to emerge or progress.

Views of Takeovers Panel in GBST

We also saw the Takeovers Panel consider these types of arrangements in the context of a number of recent competing bids for GBST Holdings Limited. There have been different views in the market about whether it is appropriate for targets to agree to these arrangements at such an early stage (i.e. before completion of due diligence and binding agreement to proceed) and also the extent to which they should be disclosed.

GBST had entered into an exclusivity arrangement in relatively unusual circumstances. It appeared to have commenced a competitive sale process and had received interest from multiple bidders, but decided to enter into exclusivity with, and provide due diligence to, only to one of those bidders. This was because of the negative impact the bidders claimed granting due diligence access to multiple competitors would have on the value of the company.

The Panel found that GBST was entitled to do this if it considered it to be in the best interest of its shareholders, referencing its previous decisions which concluded that it was legitimate for a target to trade access to exclusive due diligence. So it appears that it will generally be difficult to argue that entering into such arrangements ahead of the completion of due diligence will constitute unacceptable circumstances, even in a competitive situation.

On the question of disclosure, the Panel highlighted its existing guidance which says that the existence and nature of a lock-up device should normally be disclosed no later than when the relevant change in control proposal is announced, subject to it not being needed to be disclosed earlier under the continuous disclosure rules. In this case, the parties had voluntarily announced a summary of the terms with the proposal.

The Panel left open the question of whether the full terms of the deed should always be disclosed. However, it did indicate that it was minded to consider requiring the parties to disclose further details of the terms of the arrangements in this instance because they were required for a bidder to comply with the relevant exceptions to the exclusivity. The Panel was ultimately not required to decide this because the terms were voluntarily disclosed.

> “We expect to see more process / exclusivity agreements in 2020.”

5.6 Competition

We continued to see significant levels of competition for a number of targets during the last 12 months, with four targets subject to multiple bids, including repeated competing bids for each of Xenith IP, Pacific Energy, GBST Holdings and Healthscope, in some cases over the course of an extended period.

The numbers for the last 12 months are slightly down on what we have seen in previous years. This is probably due largely to target boards becoming increasingly better at conducting and managing competitive sales processes on their own terms, with potential bidders signing standstill agreements. This largely restricts underbidders from competing once a target has determined to proceed and announce an agreed deal with a preferred bidder.

We expect target boards will increasingly seek to get ahead of a public auction and solicit bids through a private sale process where they have greater control over the process. Targets will need to consider how best to manage and control the process, including through a properly defined process with standstill arrangements that give control over what happens after announcement. This will not always be possible, with some bidders happy to proceed on a hostile basis and others willing to sit on the sidelines during a process and put their proposal forward at a later point in time with the knowledge that target boards will always have fiduciary duties to engage.

Bidders will need to understand what is important in a competitive process and how pre-bid arrangements, target lock-ups and 'truth in takeovers' statements can be used if competition plays out in public.

We also expect more indirect competition to come from demergers. Off the back of Graincorp's proposed demerger of its malt business, announced last year, and also following the successful demerger of Coles from Wesfarmers and Domain from Fairfax the year prior, we expect to see more demergers as a means of listed companies focusing on their core business. This allows businesses valued at different multiples to re-rate and also creates competitive tension in trade sale processes.

> "We expect target boards will increasingly seek to get ahead of a public auction and solicit bids through a private sale process."

IN FOCUS ESR TAKEOVER OFFER FOR PROPERTYLINK

ESR's successful bid for Propertylink Group provides a good example of the level of competition that exists within particular strategic sectors at the moment.[5]

ESR's proposal was one of a number of competing proposals to consolidate control in the Australian industrial REIT sector. ESR had already acquired a stake of 19.79% in Propertylink and a stake of 14.99% in Centuria Capital when Propertylink acquired a 17.70% stake in its competitor, the Centurial Industrial REIT, and made a proposal to acquire 100% of the Centuria Industrial REIT.

At the same time, Centuria Capital which manages the Centuria Industrial REIT had already acquired an 11.38% stake in Propertylink and made a proposal to replace the board of directors of Propertylink. While not strictly competing bids, ESR's proposal for Propertylink was competing with a proposal by Propertylink to acquire Centurial Industrial REIT and a proposal by Centuria Capital to replace the board of Propertylink.

ESR's stated strategic goal was to expand its logistics platform into Australia and so finding a way to resolve these competing proposals in a way that enabled it to acquire such a platform was critical.

ESR was ultimately able to structure the transaction in a way which resulted in Propertylink abandoning its proposal to acquire Centuria Industrial REIT (which ESR had publicly stated it did not support) and Centuria Capital accepting ESR's offer to acquire Propertylink (which enabled ESR to acquire 100% of Propertylink).

It applied pressure on Propertylink to abandon its proposal for Centuria and agree a deal with ESR by making its proposal conditional upon Propertylink not proceeding with its bid for Centuria Industrial REIT and by committing to vote against the board spill put forward by Centuria but only if a recommended deal was agreed before the date of the board spill.

It was also able to apply pressure on Centuria to accept by making its bid subject only to a 50.1% acceptance condition. This made it clear it could proceed with the bid and close the offer without Centuria's acceptance. It also quickly announced that its offer was best and final and that it would commit to waive all conditions if it reached 50.1% by a particular date.

Ultimately, Centuria sought shareholder approval under Listing Rule 10.1 to accept ESRs offer for its stake in PLG and ESR was able to proceed to compulsory acquisition.

5.7 Truth in takeovers statements

Bidders used 'truth in takeovers' statements in three takeovers; two relating to 'no increase' statements only and one being both a 'no increase' and 'no extension' statement. All of these statements were made when the bidder had an interest of well below 50% in the target, again demonstrating the need to use strategies like this in order to appropriately incentivise shareholders to accept into the offer.

ESR's recent bid for Propertylink involved ESR successfully using a combination of these strategies including making a 'best and final' statement and committing to declare its offer free of all conditions if it reached aggregate acceptances of at least 50.1% within around one month. At the time those statements were made, ESR had voting power of 30.2% in Propertylink and within one month of making the statements it had increased its voting power to approximately 74.78%.

Truth in takeovers statements can also be used at the outset of a takeover bid as a means of creating a 'two-tier consideration' structure whereby the consideration is increased in the event that the bidder reaches a certain level of voting power. A recent example of this was Hancock's bid for Riversdale, on which Corrs advised and which also included shareholder intention statements as a means of showing support at the outset of the bid.

5 Corrs acted for ESR on all aspects of this transaction.

IN FOCUS HANCOCK PROSPECTING TAKEOVER OF RIVERSDALE RESOURCES

Following an initial subscription for 19.99% of the shares in Riversdale in late 2018, Hancock announced an off-market takeover bid in February 2019 to acquire all of the remaining shares in Riversdale.[6]

Riversdale was an unlisted public Australian-incorporated coal development company focused on hard steel making coal projects in Canada. Riversdale's main asset and primary focus is its 100% interest in the Grassy Mountain Project (Crowsnest Pass Complex, southwest Alberta, Canada).

The takeover was launched with a two-tier consideration structure. The initial offer price, A$2.20 per share, was to be increased to A$2.50 in the event Hancock's voting power in Riversdale exceeded 50%. Achieving a voting power in excess of 50% was largely dependent on its major controlling shareholder being the Resource Capital Fund (RCF) accepting into the bid. The uplift in the consideration was included as a truth in takeovers intention statement in the Bidder's Statement.

Pre-bid intention statements were provided by the three founding shareholders of Riversdale supporting the bid. The pre-bid intention statement and canvassing process were carefully managed given the recent focus on these issues by ASIC and the Takeovers Panel.

The Riversdale Board and RCF both rejected the bid and Riversdale launched proceedings in the Takeovers Panel. Hancock successfully defended those proceedings without any extension to the bid timetable.

Active opposition to the bid from Riversdale and RCF continued following acceptance by the founding shareholders.

Despite this, Hancock further increased the conditional offer price to A$2.70 per share in the event Hancock's voting power exceeded 85% in Riversdale. At the higher price, RCF accepted into the bid and at close on 21 May 2019, Hancock had successfully acquired an interest of more than 99% of the shares in Riversdale.

The takeover of Riversdale has enabled Hancock to implement its strategy of diversifying its resources operations and expanding into a new jurisdiction.

5.8 Warranty and indemnity insurance

Warranty and indemnity (**W&I**) insurance is an extremely popular tool in private M&A for underwriting warranty risks, particularly with private equity buyers and sellers. However, an increasing number of bidders in public M&A deals now take out a form of W&I insurance for some warranty protection in circumstances where they would otherwise not have. BGH Capital's bid for Navitas was a good example of this last year. The warranties are given by the target, 'diligenced' by the bidder and underwritten by the insurer in much the same way as in a private M&A deal.

We believe an increasing number of bidders will consider using this product in the future. However, its use may still be somewhat limited at this stage by two factors. The first is that bidders are still reluctant to propose W&I insurance in a competitive situation or where a recommendation is being sought from the target. This is largely due to W&I insurance not yet being considered standard market practice in public deals. Secondly, some of the most significant liabilities that bidders would be concerned about on a public deal, like class action and continuous disclosure risk, will generally be excluded from the relevant insurance policy.

6 Hancock was advised by Corrs, with some specialist advice from Herbert Smith Freehills.

> "We believe an increasing number of bidders will consider using W&I insurance in the future."

6 What did the regulators say?

Key FIRB, ACCC, ASX, Takeovers Panel and ASIC developments

Managing regulatory risk remains a key issue, particularly in larger transactions. This is because they are more likely to involve sensitive foreign investment issues, or market concentration concerns, and also attract additional attention from the corporate regulators, including ASX and ASIC.

We recently saw the A$13 billion play by CK Infrastructure Holdings to acquire APA Group blocked on foreign investment grounds, while Vodafone's proposed A$6.7 billion acquisition of TPG is in the Courts after a decision by the ACCC to block the transaction on competition grounds.

We highlight below some of the key issues we saw emerge over the course of the past 12 months, and which we think will be front-of-mind for regulators in 2020.

6.1 Takeovers Panel

The Takeovers Panel considered fewer applications in the past 12 months relating directly to takeovers and schemes than previous years.

However, the Panel remained active on other matters. There were 25 applications in total, including those on alleged associations in the context of board spill requisitions and allegations of unacceptable lock-ups relating to convertible note and other security issues.

Two key areas of focus emerged during the year in terms of policy:

Disclosure and use of equity swaps

The Panel released a consultation paper on amending its guidance regarding the disclosure of cash settled swaps to strengthen the disclosure requirements. We think these changes are generally sensible and welcome following a number of examples of significant positions taken this year without disclosure, relying on the ambiguity in the current guidance. We expect the guidance will change and that these arrangements will continue to attract attention.

Association in context of board spills

The Panel clarified in decisions in 2019 that it is prepared to consider claims of unacceptable circumstances in the context of proposed board spills in the right cases, like those in Aguia Resources. We believe this is sensible given these events can have a material impact on control and we will see more applications like this in the future. However, associations remain difficult to prove. While eight of the 25 applications this year related to alleged associations, only two were successful, with the rest failing to show sufficient material to demonstrate an association. Although it is difficult to draw any conclusion without knowing the merits of each case, the difficulty in demonstrating associations will only encourage further calls for an amendment to the law to create a 'rebuttable presumption' of association in certain cases, as there is in the UK and Hong Kong.

IN FOCUS DISCLOSURES OF ECONOMIC INTERESTS IN LISTED COMPANIES

One current area of focus for both the Takeovers Panel and ASIC is the disclosure and use of equity derivative positions.

The takeovers and substantial holding provisions do not strictly apply to equity derivatives that give the holder an economic position but not any control over voting or disposal of securities (i.e. there is no right to physical settlement).

The current Takeovers Panel guidance requires certain equity derivative positions to be disclosed but only 'where there is a control transaction'.

Early in 2019 ,the Panel released a consultation paper on a proposal to amend its guidance to provide that all long positions over 5% should be disclosed irrespective of whether there is a control transaction. The proposed changes are intended to reflect the Panel's decision that the taker of a long equity derivative position (even one that is cash-settled) may affect the market for the underlying security which could, in turn, affect the potential acquisition of control of, or a substantial interest in, the relevant listed entity.

The proposed revised guidance also suggests the Panel will treat as unacceptable acquisitions of equity derivative long positions of 20% or more in circumstances where, if the person had acquired a physical position, they would have breached the 20% takeover prohibition. In its consultation paper, the Panel specifically sought comments on this position and we are interested to see the response to this proposal.

There has been some uncertainty to date about both the circumstances in which disclosure, is required (i.e. when is there a 'control transaction') and whether it is unacceptable to have an economic position under an equity derivative above 20%.

Where used in connection with a proposed transaction, most acquirers would elect to disclose, and there have been few examples of aggregate positions above 20% because of the uncertainty about the position. The uncertainty around disclosure arises mainly where there is not necessarily a control transaction proposed at the time of acquisition.

This has been highlighted by recent examples, including Portsea Asset Management's disclosure of a stake of approximately 14% in Speedcast Limited. This was reported to have been accumulated without disclosure under a swap with UBS. This was also the case with WIN's accumulation of an aggregate cash plus physical position in Prime Media of more than 20% which then led ASIC to require that WIN sell part of its stake to reduce its aggregate position below 20%.

6.2 ASIC

The two key areas of focus for ASIC we have seen emerge and expect to be important in 2020 are:

Stub equity

ASIC has, over the course of the past 12 months, been critical of the offer of interests in proprietary companies to retail shareholders through stub equity structures. It has since proposed amendments to the corporations legislation to ban the use of custodian structures in takeovers and schemes where used to avoid the takeover rules applying, and prohibit the offer of shares in a proprietary company under a takeover or scheme without a prospectus.

While the proposals have not yet become law, we expect to see a shift away from the use of proprietary companies and custodian arrangements towards alternative structures for management rollovers. We have already seen bidders for Scottish Pacific and QMS Media limit their respective offers of stub equity to management and Brookfield, in its bid for Healthscope, use a public unlisted company for its offer of stub equity (although it still used a custodian structure).

Truth in takeovers

ASIC has been very focused on holding market participants to public statements on intention in connection with takeovers. It first published guidance on this issue in 2002 and this has not been substantially updated since. The Panel considered whether to update its guidance on truth in takeovers statements in 2018 and made only a very small change to its guidance. This change clarified that departures from truth in takeovers statements within four months of them being made are likely to be unacceptable and that they can be unacceptable if made in relation to takeovers or schemes.

The Panel also previously released a guidance note on shareholder intention statements which notes that they may lead to unacceptable circumstances if the way in which they are obtained creates a relevant interest or association and there has been a breach of the takeovers laws. ASIC has recently taken a stronger view and has intervened in a number of deals on the basis that shareholder intention statements obtained by, or for the benefit of, a bidder have given the bidder a relevant interest in the shares of the shareholder giving the statement. We understand that ASIC is considering what further steps it should take in this area and expect that it will at least provide clear guidance on this point, and may even look to amend the law to clarify when a shareholder intention statement gives another person a relevant interest.

6.3 FIRB

Foreign investment approval continues to be an important part of doing deals in Australia, both because of the significant percentage of deals accounted for by foreign acquirers and the fact that many of these acquirers are private equity funds. These funds will usually be treated as 'foreign government investors' under our foreign investment regime and subject to lower approval thresholds. This means that almost all deals need to be approved.

Australia is very open to foreign investment and the large majority of applications are approved. Having said that, there will still be some significant transactions that raise concerns from a national interest perspective and may be rejected or subject to additional conditions. It is therefore important to manage the process carefully, particularly in sensitive sectors or in relation to assets which may raise national security concerns.

An example of such a transaction that was rejected last year was the A$13 billion bid by CK Infrastructure Holdings to acquire APA Group, which was refused on the basis of concerns about the concentration of foreign ownership of a strategically important asset. This is also a good example of the type of transaction where FIRB would have consulted closely with the new Critical Infrastructure Centre.

Two key areas of focus we saw emerge and expect will be important in 2020 are:

Data security

Recent comments from the FIRB chairman confirm that the Board sees data as critical infrastructure and is focused more than ever on data security and developing conditions to approvals that ensure data is appropriately protected following an acquisition. This will be an important factor in any deal involving sensitive private data about Australians, particularly in the healthcare and data centre sectors. In future, we expect to see FIRB imposing new conditions in relation to this issue which will focus on cyber security and require acquirers to audit the cyber security credentials of not only themselves but also other firms in their supply chain.

Tax conditions

FIRB has for some time now imposed what it calls a 'standard' list of tax conditions in respect of all approvals. What we are now seeing, however, is the imposition of additional tax conditions which focus on particular issues that concern the ATO. A good example is transactions between entities within a stapled group which has been the subject of new laws in the past year. Some of these conditions can be quite onerous and require disclosure to the ATO of significant information which it might not otherwise be able to readily access. We expect this focus to continue next year.

> “Australia is very open to foreign investment and the large majority of applications are approved.”

6.4 ASX

ASX-listed companies will often need to engage with the ASX in relation to a number of issues on public M&A transactions, including whether or not any shareholder approvals are required because of the issue of securities (Listing Rule 7.1), related party transactions (Listing Rule 10.1) or the significant size or nature of the transaction (Listing Rule 11).

Two areas of focus for the ASX last year we expect will be important in 2020 are:

Related party transactions

The ASX revised its guidance on related party transactions last year to significantly reduce the scope for waivers from the requirement to obtain shareholder approval for related party transactions. It used to be possible to obtain a waiver in circumstances where it could be said the circumstances provided 'no incentive' for there to be a shift in value or that the conflict of interest would otherwise be addressed. However, the ASX has expressly raised the bar by stating in its revised guidance that the applicant must establish that there is 'no reasonable prospect of the counterparty influencing the terms of issue or transaction to favour themselves at the expense of the entity'. Furthermore, the ASX has now set out a detailed set of factors it will apply in determining whether an ASX-listed fund will be able to meet this test in seeking waivers for transactions between different managed funds and mandates. While the ASX has softened the position initially outlined in its original draft guidance, it is clearly indicating that these waivers, previously relied upon to establish new listed trusts or transfer assets to existing unlisted trusts, will be harder to obtain in the future and will certainly be more closely examined to ensure there is no reasonable prospect of undermining the policy.

Significant transactions

The current rules and guidance in relation to significant transactions will generally not require approval for significant transactions unless they:

- result in the issue of more than 100% of the listed entity's equity (i.e. a reverse takeover);
- result in the disposal of a listed entity's main undertaking or leave it effectively a 'cash box'; or
- effectively result in a backdoor listing of an unlisted business or there is some other significant change in the 'nature' of the business aside from scale.

This position contrasts with that of a number of exchanges—including the HKSE, NYSE and LSE—that require approval for any transactions above a certain materiality threshold in scale (usually 25% or up to 50%). This position surprised many in the market last year when AMP was able to sell its life insurance business to Resolution Life (which represented close to 50% of AMP on many metrics) without shareholder approval. A number of shareholders of AMP argued that they should have a right to approve the transaction and lobbied the ASX to require such an approval. We do not expect the rules to change soon. They were recently revised following a public consultation and the only change was to require approval for reverse takeovers. However, we do expect this issue to come up again, and there to be similar concerns raised where significant transactions proceed without shareholder approval. We also expect that at some point in the future the position will be revisited.

6.5 ACCC

As we see businesses look to grow by consolidation in a low growth economic environment, it is inevitable that there will be more deals that raise competition concerns.

Although there were a number of significant public M&A transactions that the ACCC considered, the last 12 months saw a further decline in the transparency of the ACCC's reasoning. Over 90% of deals (and, it is expected, a number of public M&A transactions) were cleared by the ACCC through its confidential, short-form 'pre-assessment' process, following which no competitive analysis is published. The ACCC will pre-assess a proposed transaction if it considers that it can form a view that it will not substantially lessen competition without conducting a public review and obtaining interested third-party input. One trend we are seeing is that the ACCC is increasingly willing to use the pre-assessment process for straightforward reviews, allowing it to commit more of its resources to public reviews of a relatively small number of complex or contentious deals. This has generally meant that public reviews are becoming longer and more difficult to navigate with indicative ACCC timelines more frequently extended. 'Statements of Issues' and second-phase reviews are more likely, and the ACCC will increasingly use its compulsory evidence-gathering powers to obtain internal documents and examine business executives.

Two public M&A transactions in 2019 were particularly notable from an ACCC perspective: Vodafone's proposed acquisition of TPG, which the ACCC opposed after an intensive eight-month investigation, and AP Eagers' proposed acquisition of Automotive Holdings Group (AHG), which the ACCC cleared under the recently reformed merger authorisation process.

Loss of potential competition

The Vodafone / TPG decision is interesting because of its heavy reliance on an argument about the loss of 'potential competition'. The ACCC's concern was that the transaction would eliminate prospective competition from TPG in the retail mobile market. TPG had previously announced that it would enter with a fourth mobile network, but then abandoned those plans, ostensibly as a result of the Federal Government's ban on TPG's preferred Huawei 5G equipment. The ACCC's view was that, notwithstanding the Huawei ban, there was a 'real chance' that TPG would enter, and its entry would result in a substantially more competitive retail mobile market given there are only three existing players in Vodafone, Telstra and Optus. In response to the ACCC's decision to oppose, the parties are currently seeking a declaration from the Federal Court that the deal does not substantially lessen competition. In those proceedings, evidence from TPG's executives supporting a view that there is now no prospect of TPG independently entering the retail mobile market may well be determinative. More broadly, the ACCC's opposition in the Vodafone / TPG matters again demonstrates its willingness to oppose major transactions in high-profile sectors based on concerns over the loss of potential, rather than actual, competition on relevant markets. This concern also underpins an emerging ACCC strategy to scrutinise digital platform and technology transactions more closely.

Use of new merger authorisation process

In AP Eagers and AHG, the parties each supplied new and used cars, trucks and buses, as well as associated products and services, and had largely geographically complementary automotive dealer networks. This was the first use of the merger authorisation process since the 2017 reforms, which took first-instance consideration of merger authorisation applications out of the hands of the Australian Competition Tribunal and gave it to the ACCC. Under the merger authorisation process, the ACCC has an extendable three-month period in which to make its determination. The ACCC can authorise a merger on the basis that it does not substantially lessen competition or, alternatively, that it results in net public benefits (i.e. notwithstanding any lessening of competition). In this matter, the ACCC ultimately granted authorisation within three months on the basis of a conventional undertaking to divest dealership assets in the one geographic area of significant overlap. It remains unclear why the parties preferred the merger authorisation route, particularly given that their substantive arguments were almost wholly on the point of any substantial lessening of competition and so are likely to have been the same as those presented in a more conventional informal clearance process. Almost no evidence of net public benefit was presented. Unfortunately, given how straightforward this particular case was, there still remains significant uncertainty about how the ACCC will approach this process in more contentious matters. Other market concerns are around the ability to control or influence timing, a lack of access to confidential aspects of third-party submissions, the rigour of the ACCC's analysis and the limited appeal rights.

Two trends we think will be important in 2020 are:

Focus on data

Following on from the release of the final report in its Digital Platforms Inquiry, the ACCC will continue to ramp up its focus on the acquisition of significant data assets and targets that represent potential or nascent competitive threats to bidders. In relation to data, ACCC Chairman Rod Sims recently stated: "We are now very much alive to the significance of data and the implications of...network effects" and, in relation to potential competitive threats: "... if the prospect that the target will become an effective competitor is small, but the potential increase in competition and consumer welfare is large, greater weight should be put on the potential for competition". These issues have gained increasing prominence in recent ACCC reviews, and the ACCC has sought to formalise its approach by proposing two new mandatory merger analysis factors, which the ACCC must take into account in any review (the Government's response to those reform proposals remains to be seen but it is likely to be receptive).

Positioning for reform

The ACCC is also positioning itself for further reforms to Australia's merger control regime, advancing proposals that would strengthen its ability to successfully oppose mergers in litigation. The ACCC has a weak recent record in challenging transactions before the Australian Courts. One of those proposals is to introduce a 'rebuttable presumption' that a merger opposed by the ACCC is anti-competitive unless the merger parties provide a court with clear and convincing evidence to the contrary, stacking the deck very much in favour of the ACCC. While the ACCC has not yet formalised these proposals, we expect the ACCC position to crystallise, and calls for reform to intensify, if its poor track record in merger litigation continues and, in particular, if it is unsuccessful in its current litigation in the Vodafone / TPG matter.

“The ACCC is positioning itself for further reforms to Australia's merger control regime.”

7 Corrs Deal Review Database

7.1 Corrs Public M&A Database

Corrs collated and drew on an extensive database for the statistics and trends outlined in this publication.

Our detailed analysis utilised our unique database covering all announced takeovers and schemes with a deal value over A$25 million from 2011 to 2019.

We would be delighted to assist and help with specific queries on deal statistics and market trends relating to public M&A activity, including deal structures and pre-bid stakes, rival bid strategies, target engagement, announcements, recommendation, pre-bid strategies, deal protection (such as lock up devices and break fees), bid conditions, truth in takeover statements, tiered bid structures, getting to compulsory acquisition, sector activity, consideration, bidders and foreign investment.

Please feel free to contact a member of the Corrs M&A team for any queries you may have.

7.2 Methodology

In producing this publication, we reviewed data from a deal sample of 47 takeover bids and schemes of arrangement, which:

- involved an Australian-listed target;
- were announced between 1 October 2018 and 30 September 2019; and
- had a deal value over A$25 million.

A full list of all deals in our database is set out in Appendix A. Information in relation to these deals is current to 30 September (unless otherwise specified in this publication). As at that date, 11 schemes and four takeovers from the deal sample were ongoing.

The information used was largely obtained from our own in-depth research and market analysis along with primary sources such as ASX announcements, bidder and target statements and scheme booklets.

7.3 Appendix A – deal list

	Target	Bidder	Date announced	Deal value	Bid/Scheme	Final %
1	The Reject Shop Ltd	Allensford Pty Ltd	21/11/2018	**$78,051,999**	On-market bid	**18.99%**
2	Watpac Ltd	BESIX Group SA	29/10/2018	**$168,715,344**	Off-market bid	**100%**
3	Macphersons Resources Limited	Intermin Resources Limited	11/12/2018	**$28,887,900**	Scheme	**100%**
4	Asia Pacific Data Centre Group	NextDC Ltd	8/10/2018	**$230,000,000**	On-market bid	**100%**
5	Century Australia Investments Limited	WAM leaders Ltd	13/11/2018	**$85,302,885**	Scheme	**100%**
6	Xenith IP Group Ltd	QANTM Intellectual Property Ltd	27/11/2018	**$156,942,020**	Scheme	Terminated/ Withdrawn
7	Eclipx Group Ltd	McMillan Shakespeare Ltd	28/11/2018	**$862,043,540**	Scheme	Terminated/ Withdrawn
8	Doray Minerals Ltd	Silver Lake Resources Ltd	14/11/2018	**$142,172,828**	Scheme	**100%**
9	Stanmore Coal Ltd	Golden Energy & Resources Limited / Ascend Global Investment Fund	19/11/2018	**$239,210,929**	Off-market bid	**25.47%**
10	Greencross Ltd	TPG Telecom Limited	10/10/2018	**$675,000,000**	Scheme	**100%**
11	Healthscope Limited	Brookfield Capital Partners Limited	12/11/2018	**$4,291,963,825**	Other (scheme and off-market bid)	N/A
12	MYOB Group Ltd	Kohlberg Kravis Roberts & Co. L.P.	8/10/2018	**$2,008,727,439**	Scheme	**100%**
13	Automotive Holdings Group Ltd	A P Eagers Limited	5/04/2019	**$836,426,935**	Off-market bid	Ongoing
14	Navitas Ltd	BGH Fund / Australian Super Consortium	15/01/2019	**$2,086,812,471**	Scheme	**100%**
15	DuluxGroup Limited	Nippon Paint Holdings Co Limited	17/04/2019	**$3,756,264,932**	Scheme	**100%**
16	Mareterram Limited	Sea Harvest Group Limited	5/02/2019	**$38,600,000**	Off-market bid	**100%**

	Target	Bidder	Date announced	Deal value	Bid/Scheme	Final %
17	Xenith IP Group Ltd	IPH Ltd	12/03/2019	**$191,758,396**	Scheme	**100%**
18	Ruralco Holdings Ltd	Nutrien Ltd	27/02/2019	**$462,229,887**	Scheme	**100%**
19	NetComm Wireless Ltd	Casa Systems Inc	22/02/2019	**$160,962,897**	Scheme	**100%**
20	Gazal Corporation Ltd	PVH Corp	21/02/2019	**$268,125,084**	Scheme	**100%**
21	Highlands Pacific Ltd	Colbalt 27 Capital Corp	2/01/2019	**$114,737,053**	Scheme	**100%**
22	Spicers Ltd	Kokusai Pulp & Paper Co Ltd	17/01/2019	**$88,448,534**	Scheme	**100%**
23	Orion Health Group Limited	Grafton Health Holdings Limited	7/02/2019	**$106,140,564**	Off-market bid	**100%**
24	Nzuri Copper Ltd	Xuchen International Ltd	27/02/2019	**$109,485,032**	Scheme	Ongoing
25	Creso Pharma Ltd	PharmaCielo Ltd	7/06/2019	**$122,000,000**	Scheme	Ongoing
26	Bligh Resources Limited	Saracen Mineral Holdings Limited	14/06/2019	**$38,200,000**	Off-market bid	**100%**
27	CBG Capital Ltd	Clime Capital Ltd	18/06/2019	**$27,069,126**	Off-market bid	**100%**
28	Gindalbie Metals Ltd	Ansteel Group	11/03/2019	**$38,988,534**	Scheme	**100%**
29	8IP Emerging Companies Limited	Aurora Funds Management	5/04/2019	**$30,763,581**	Off-market bid	Terminated/ Withdrawn
30	Mercantile Investment Company Limited	Sandon Capital Investments Limited	3/06/2019	**$47,322,620**	Off-market bid	**100%**
31	Kidman Resources Ltd	Wesfarmers Limited	2/05/2019	**$769,115,066**	Scheme	**100%**
32	ERM Power Ltd	Royal Dutch Shell plc	22/08/2019	**$605,698,235**	Scheme	Ongoing
33	Australian Unity Office Property Fund	Charter Hall Group / Abacus Property Group	4/06/2019	**$495,009,134**	Trust scheme	Ongoing

	Target	Bidder	Date announced	Deal value	Bid/Scheme	Final %
34	Dreamscape Networks Limited	Web.com Group, Inc.	24/07/2019	**$104,988,600**	Scheme	**100%**
35	Aveo Group	Brookfield Property Group	14/08/2019	**$1,248,585,995**	Scheme	Ongoing
36	Wellcom Group Limited	Innocean Worldwide Inc	31/07/2019	**$262,836,685**	Scheme	Ongoing
37	Villa World Limited	Avid Property Group Australia Pty Ltd	14/03/2019	**$293,500,024**	Scheme	Ongoing
38	EganStreet Resources Ltd	Silver Lake Resources Ltd	30/07/2019	**$52,000,000**	Off-market bid	Ongoing
39	Pacific Energy Ltd	OPTrust / Infrastructure Capital Group Consortium	10/09/2019	**$460,199,075**	Scheme	Terminated/ Withdrawn
40	Macquarie Media Ltd	Fairfax Media Ltd	12/08/2019	**$249,958,652**	Off-market bid	**100%**
41	GARDA Capital Group	GARDA Diversified Property Fund (GDF) / GARDA Holdings Limited (GHL)	20/09/2019	**$62,586,240**	Scheme	Ongoing
42	GBST Holdings Ltd	Kiwi Holdco CayCo	8/07/2019	**$261,463,155**	Scheme	Ongoing
43	Bellamy's Australia Limited	China Mengniu Dairy Company Limited	16/09/2019	**$1,434,108,957**	Scheme	Ongoing
44	Echo Resources Limited	Northern Star Resources Limited	27/08/2019	**$228,061,136**	Off-market bid	Ongoing
45	Pacific Energy Ltd	QIC Private Capital Pty Ltd	24/07/2019	**$460,199,075**	Scheme	Ongoing
46	Azumah Resources Limited	Ibera Capital Fund LP	18/09/2019	**$27,397,492**	Off-market bid	Ongoing
47	Silver Chef Ltd	Next Capital Pty Ltd Consortium	3/07/2019	**$27,487,541**	Scheme	Terminated/ Withdrawn

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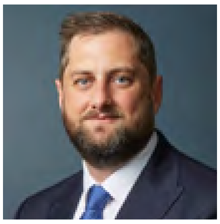

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