AUSTRALIAN PUBLIC M&A IN A COVID-19 WORLD — GOLD SHINES, PRIVATE EQUITY STAYS ACTIVE AND GREEN SHOOTS EMERGE

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News

A new report released by Herbert Smith Freehills shows that public M&A activity in Australia was significantly impacted by the COVID-19 pandemic during the 2020 financial year. However, the allure of targets in the gold sector shone brightly, private equity bidders proved active, and bidders and targets across the market adapted to the new environment in pursuit of deal certainty and flexibility.

The firm's twelfth annual *Australian Public M&A Report 2020*, released today, examines the 51 control transactions involving Australian ASX listed targets that were conducted (or announced as intended to be conducted) by way of takeover bid or scheme of arrangement in the 2020 financial year. Activity between January and May 2020 was significantly reduced as bidders retreated from the market as a result of COVID-19 and the global uncertainty and economic effects flowing from it.

Herbert Smith Freehills partner and co-author of the Report, Nicole Pedler, said, "While uncertainties caused by the pandemic deterred some bidders, others saw opportunities in the Australian market. In particular, since the onset of COVID-19 in the second half of FY20, we saw continued interest in the energy and resources sector.

"Gold proved to be the highest value target in the sector making up A$1 billion of the cumulative A$2.4bn value of energy and resources deals."

The Report found that energy and resources deals in FY20 remained largely consistent with FY19 levels, accounting for 37% of all public M&A deals. Almost half of the public M&A deals announced in the second half of FY20 involved targets in this sector, with targets including Cardinal Resources and Spectrum Metals.

The remainder of the deals announced in the second half of FY20 were for targets in sectors such as utilities, health care, telecommunications, financial services and real estate.

Ms Pedler explained, “The continued interest in resources and especially gold is unsurprising given the relative value seen in gold during times of economic uncertainty. While no sector is pandemic-proof, the interest in utilities, health care, telecommunications, financial services and real estate shows that bidders are focussed on businesses with a strong path through and beyond the pandemic.”

Another strong performer during FY20 was private equity, which emerged as an enthusiastic capital provider.

The Report found that private equity bidders accounted for 29% of all deals in FY20 — an all-time high compared to the last five years — almost triple the levels of FY17 and more than 10% higher than in FY18. Private equity bidders were particularly active in both the industrials and utilities sector and in energy and resources.

Herbert Smith Freehills partner and co-author of the Report, Kam Jamshidi, said, “Private equity is here to play. With the benefit of having seen how the global financial crisis unfolded and willed-on by highly liquid limited partners, private equity has demonstrated a willingness to provide capital in take-privates even with the economic uncertainty and downturn connected with the pandemic.”

The Report found that Australia’s public M&A market enjoyed a strong start to FY20, with the number of deals announced from July to October similar to that seen in FY19. However, from January 2020, Australian public M&A weakened and continued to decline as the world’s markets weathered the pandemic.

By the end of the financial year, total deal value had reached $13.4 billion — significantly lower compared to levels achieved in recent years (A$45.9bn in FY19, A$40.9bn in FY18 and $23.4bn in FY17). There was also a decrease in M&A deal value relative to the number of deals, with only two ‘mega deals’ of more than A$1 billion announced during the year — the lowest Herbert Smith Freehills has recorded in its twelve editions of the annual report.

Mr Jamshidi said, “With a crisis of this magnitude, it is inevitable that large strategics will shy away from company-defining mergers, and this is the core driver for the overall lower deal value this year. As economic conditions settle, we expect the mega-mergers to return, as companies look for inorganic growth and ways to rationalise their cost base.”

The Report found that the success rate of deals was also lower than in previous years at 63%, down from 74% in FY19.

Mr Jamshidi added, “This year we saw a number of bidders attempt to renegotiate or walk away from agreed deals as a result of alleged defaults arising in connection with the impacts of the pandemic, whether for material adverse change in the target or breach of obligations or conditions in implementation agreements. What has been interesting is how targets have responded to this heightened execution uncertainty.

“On one hand, approximately one third of deals containing material adverse change conditions carved out the effect of COVID-19 after the pandemic hit. On the other hand, the percentage of deals with a reverse break fee, payable by a bidder for not completing a transaction, declined from 46% to 37%.”

The Report also reflects on the changes to Australia’s foreign investment regime in response to the pandemic, including the temporary implementation of a A$0 screening threshold and the extension of the processing timeframe by the Foreign Investment Review Board (**FIRB**) to give approval on foreign investment applications from 30 days to up to six months.

Ms Pedler added, “While FIRB’s changes are significant, they do not appear to have dissuaded foreign bidders.”

“In fact, the proportion of foreign bidders by number was largely unchanged from FY19, with offshore bidders accounting for 60% of the total value of deals in FY20, reflecting a continued high level of inbound investment into Australia.”

Ms Pedler suggested that there are reasons to be optimistic, saying, “In positive signs for the market’s recovery, activity increased significantly towards the end of FY20, with nine deals announced in June. A further twelve deals have been announced as at the end of September 2020.

“It is too early to call, but we are optimistic about this surge of activity continuing throughout the 2021 financial year. We also expect to continue to see robust defences put up by targets testing all their options despite difficult conditions.”

Additional findings of the Report include:

- A proportionately high number of bidders offered ‘mega’ premiums of over 50% of the target’s undisturbed share price (47% of unsolicited bids and 31% of friendly bids).
- Cash re-emerged as the preferred form of consideration, with 74% of all deals offering shareholders only cash (66%) or a choice of cash (8%) as consideration.
- In FY20, more schemes were used than takeovers as compared with previous years (57% in FY20, 49% average across FY15-19).

- Levels of competitiveness increased in FY20 compared to FY19 with seven targets subject to competitive bids.
- 72% of deals in FY20 were launched with target board support (‘friendly’ deals), consistent with the tendency towards friendly deals seen in previous years. As with FY18 and FY19, all mega deals were announced with the support of the target board.
- There were more unsolicited bids in the second half of FY20 (43% compared to only 18% in H1) as confident bidders took advantage of the turbulent environment to capitalise on the opportunities presented by COVID-19.

Find more information and a copy of the full *Australian Public M&A Report 2020* here

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