Takeovers: 8 trends and takeaways

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In brief: While below the extraordinary levels of recent pandemic years, Australia has seen significant public merger and acquisition (**M&A**) activity so far in 2023.

Amidst a subdued initial public offering (**IPO**) market, reduced levels of venture capital investment, a volatile share market and other current economic circumstances, there have been notable changes in takeover trends.

This article delves into eight noteworthy trends and takeaways for investors, directors and shareholders.

1 Reduced market valuations are driving opportunistic offers

What is happening?

Recent share market pricing has influenced takeover activity. With the fall of the ASX-200 and share market pricing more generally, the boards of listed companies have been confronted with lower market valuations that do not align with their self-assessed worth.

Acquirers use the lower market pricing to make, what some see, as opportunistic offers.

The valuation mismatch between acquirers and target companies also helps to explain the hostility of some recent takeover attempts and associated applications brought before the Takeovers Panel.

Where a target company board disagrees with the market's assessment of price - in circumstances where an acquirer sees an opportunity to take control of a company at a reduced price - the acquirer may not be able to obtain the board's support.

What are some examples?

This trend has been particularly evident in the technology sector which saw a period of significant and rapid price decline.

Potentia Capital's contested takeover of Nitro Software Ltd has been referenced as an example of opportunistic bidding. Potentia Capital's bids ranged from $1.80 to $2.25 per share after Nitro Software stock dropped from a high of $3.815 per share in November 2021 to a low of $1.15 per share in July 2022. Resistance was evident from Potentia Capital's application to the Takeovers Panel alleging that the Nitro Software board was not disclosing sufficient information to shareholders. Five of the seven pre-takeover directors of Nitro Software resigned following the deal.

The Australian Clinical Lab Ltd (**ACL**) proposed takeover of Healius Ltd has also been described as 'opportunistic' as it seeks to become the largest pathology provider in Australia with essentially a nil-premium offer. Healius became a takeover target after suffering an interim loss in February 2023. Healius' board have continued to speak against the takeover bid. As at the date of this note, the offer remains subject to the outcome of an ACCC determination relating to competition concerns.

What do we expect going forward?

While market prices remain below previous heights, we expect offers seen as opportunistic will continue to be made. Board pushback will be ongoing until companies concede to a new market reality or share prices increase. Ultimately, boards are subject to directors' duties to act in good faith in the best interests of the company, meaning they cannot simply reject a takeover offer without first giving the offer well-reasoned consideration.

2 Bidders are structuring concurrent schemes and takeover bids

What is happening?

Schemes of arrangement have remained a popular transaction structure where an acquirer obtains target board support and seeks transaction certainty. However, they do suffer from a lack of flexibility if a competing bidder arises. The issue for schemes is that the process generally takes about four months to implement, if not longer, but the pricing must be settled upon early in the formal process. It is not easy to increase the return received by target shareholders if a competing takeover offer is made on better terms by another bidder. By comparison it is relatively easy to increase a takeover offer.

We are seeing offers involving concurrent schemes and takeover bids which are intended to provide flexibility if the scheme is not ultimately approved (such as in the event that a competing bid is made at a better valuation than that put to shareholders as a scheme of arrangement).

What are some examples?

Both the contested bids for control of Nitro Software and for control of Virtus Health Ltd included concurrent scheme and takeover bid deal structures.

Each of the Takeovers Panel and ASIC have publicly stated that a concurrent takeover/scheme structure is not inherently unacceptable. However, ASIC did state in its submissions to the Takeovers Panel on the Nitro Software matter that it will approach such structure on a case-by-case basis depending on the particular facts.

What do we expect going forward?

Given the green light from regulators and the solution this structure provides to the inflexibility of schemes, we expect other offers to be structured as concurrent schemes and takeover bids so as to retain the advantages of a scheme but retain flexibility in a competitive scenario. Despite acquiescence by regulators to date, we expect further offers structured in this way, may still be subject to regulatory challenge while the practice remains new.

3 ESG factors are driving takeover activity

What is happening?

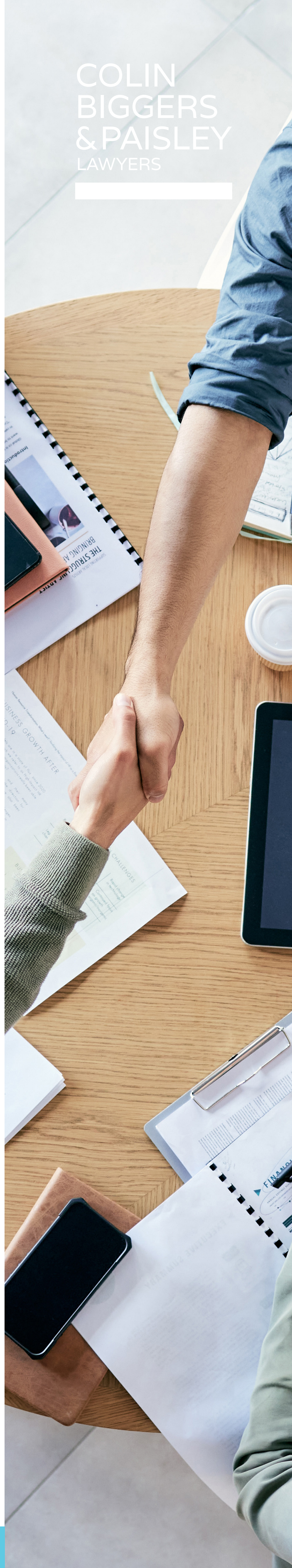
Environmental, social and governance (**ESG**) factors have driven some recent high profile takeover activity and related shareholder activism.

What are some examples?

The Brookfield and EIG consortium stated that their takeover of Origin Energy Ltd is part of a 'whole of society' approach to achieve net zero greenhouse gas emissions. In an attempt to sway shareholders and regulators into accepting the takeover proposal on ESG grounds, Brookfield vowed to contribute $30 billion to renewable energy installations and increase their electricity output by an additional 10 gigawatts by 2033. Regardless of whether these statements provide a fulsome explanation of the acquirers' motivations, their use of language is interesting in itself.

Noting that AGL Energy Ltd (**AGL**) coal and gas-fired energy stations account for roughly 8% of Australia's carbon footprint, Michael Cannon-Brookes led AGL shareholders to protest a demerger proposal under which AGL would be split into separate clean and fossil fuel AGL entities. Ultimately, slick PR was a key factor in the AGL board withdrawing its proposal.

Another potential example is the BHP Group Ltd divestment of petroleum assets and bid to acquire Oz Minerals Ltd which could be seen as divestment of assets with less favourable ESG characteristics and acquisition of assets with more positive



ESG friendly aspects. Oz Minerals describe their assets as modern minerals and explain their strategic aspirations for their products to be *"high purity, support a decarbonising world, have a zero carbon footprint and are traceable from mine to end user."*

What do we expect going forward?

We expect the Labor Government's target of reducing Australia's greenhouse gas emissions by 43% below 2005 levels by 2030 to require significant investment in renewable energy and related infrastructure such as battery storage technology. This will provide impetus for further deals where ESG is a driving factor. For example, there is likely to be aggressive competition for companies holding rare earth mineral assets needed for batteries and other technological uses.

4 Target boards and acquirers continue to challenge each other's disclosure

What is happening?

Attacking another party's disclosure is a well worn tactic used in hostile takeover bids. Recent applications to the Takeovers Panel provide cautionary tales for both potential acquirers and target boards to provide adequate information to target company shareholders. In particular, all information should be disclosed that may affect control of the target company or needed to enable shareholders to adequately assess the merits of takeover bids. Parties wishing to challenge deals - such as competing bidders - will often highlight disclosure weaknesses in applications to the Takeovers Panel to derail or slow a bid.

The Takeovers Panel can make a declaration of unacceptable circumstances if they consider target companies are not receiving sufficient and relevant information to allow them to assess the true merits of a takeover bid and regularly highlight the importance of getting disclosure right.

What are some examples?

Potentia Capital recently unsuccessfully sought intervention by the Takeovers Panel on the grounds that Nitro Software were not disclosing the risks associated with the Rocket BidCo Pty Ltd competing takeover to the alleged detriment of Nitro Software shareholders not receiving all relevant information to assess the relative merits of all takeover bids before them.

Similarly, Healius, despite being unsuccessful, submitted an application to the Takeovers Panel seeking such a declaration on the grounds that the information in ACL's accompanying Bidder's Statement was misleading to Healius shareholders. The Takeovers Panel did made clear that information regarding the commercial tactics behind an acquirer's decision to make a takeover bid is not generally something the Takeovers Panel considers relevant information.

In late 2022, two applications were brought before the Takeovers Panel relating to Mineral Commodities Ltd and DRA Global Ltd where the Takeovers Panel made declarations of unacceptable circumstances due to failures to disclose conflicts of interest.

What do we expect going forward?

Though the Healius decision shows the reluctance of the Takeovers Panel to involve itself in the commercial politics around takeovers, these applications nevertheless highlight the importance of disclosing all relevant information, including any conflicts of interests and associated risks, to enable target company shareholders to appropriately assess the merits of takeover bids.

We expect challenging adequacy of disclosure to remain a tactic used by boards seeking to challenge the merits of bidders' offers and bidders seeking to challenge competitors' offers as well as board responses.

5 Private equity continues to be involved in take-privates

What is happening?

When pricing becomes more attractive, private equity (**PE**) shifts some of its focus to public company takeovers. The ten largest PE deals so far in 2023 have all been take-privates. Moreover, the value of PE-backed take-private deals formed 81% of all PE deals by value in Q1 2023. This is a historic high, with take-privates forming 37% of all PE deals in 2022, 25% in 2021 and 13% in 2020. The takeover bid of Slater and Gordon by Allegro Funds is an example of such activity.

This trend can be correlated to the extent of dry powder at the disposal of PE firms with the ongoing decline in PE-backed IPOs, going from 287 in 2021 to four in Q1 2023. It can also be attributed to PE capitalising on the opportunities in the technology sector, with 50% of PE's total activity in Q1 2023 by value coming from tech-focused deals.

What are some examples?

Examples of successful PE bids include the takeovers of Elmo Software Ltd, Nitro Software and Pushpay Holdings Ltd. More generally, these bids provide evidence of PE firms taking advantage of reduced valuations.

The market cap for Origin Energy Ltd - another company under offer - was $15.3 billion at the time of this article. Origin Energy is relevantly being taken private by a team of PE firms led by Brookfield.

What do we expect going forward?

We expect PE to remain interested in acquisitions via the publicly listed market. However, further interest rate increases have potential to increase the cost of money and reduce borrowing power. Further PE will be attuned to the market valuations and we may see a decree in activity if share prices materially increase.

6 Big superannuation fund involvement is increasing the size of target companies

What is happening?

Superannuation funds are a $3.5 trillion industry and recipients of an ongoing stream of compulsory superannuation contributions. The share weight of money and what many see as attractive market prices have brought about their involvement in funding takeover deals, to an extent previously unseen, often together with PE.

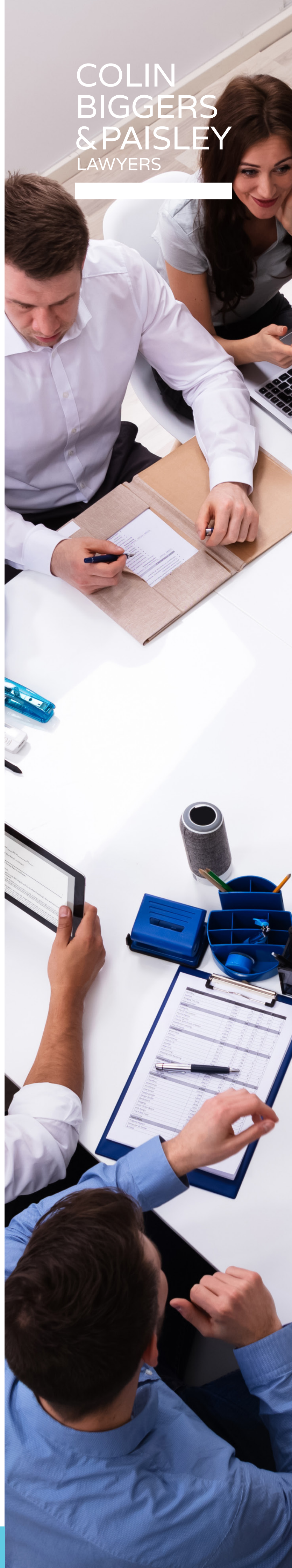
What are some examples?

Notably, Sydney Aviation Alliance, which is a consortium of investment funds including UniSuper, QSuper and Australian Super, acquired Sydney Airport in a mega $23.6 billion cash takeover in 2022.

Commonwealth Superannuation Corporation were involved in the $3.4 billion takeover of Uniti Group led by Brookfield. Aware Super and HESTA Super Fund have also recently publicised their desire to be involved in takeover opportunities.

What do we expect going forward?

Funds have proclaimed their continuous open-mindedness to future privatisation opportunities because of the long-term returns that private assets can bring their members. Investing in companies that have been taken private may also be seen to mitigate the risks of volatile returns during an unpredictable share market.



7 Foreign investment represents a large stake of Australian takeovers

What is happening?

In 2022, foreign investment via Australian M&A surged. Foreign involvement in Australian M&A deals has seemingly returned to pre-pandemic levels. In particular Australian target companies have seen material interest from US private equity acquirers taking advantage of the stronger US dollar. Particularly in situations where the target operates a substantial business in the United States.

Foreign involvement has primarily focused on companies operating in the technology and resource sectors.

What are some examples?

The SS Silver II Pty Ltd takeover of Crown Resorts Ltd is an example of US PE investment.

Other examples of foreign involvement include the Thoma Bravo LP takeover of Nearmap Ltd for $1.1 billion and the takeovers of Tassal Group Ltd and CIMIC Group by Canadian and Spanish investors respectively.

What do we expect going forward?

We expect to see further foreign investment going forward, especially investors from North America and Europe who benefit from relatively favourable currency conversion rates as at the date of this document.

However, changes to Foreign Investment Review Board (FIRB) requirements commencing 1 July 2023 may influence future activity. The Australian Government is imposing new reporting obligations for foreign investors with the intention of gaining better visibility of foreign ownership in Australia.

There are a few notable takeaways from the new regime for foreign investors. Specifically, if a relevant person fails to submit any required notifications within a 30-day period, they may be subjected to a fine. In the new regime, ignorance is not always an excuse. This can be troublesome for foreign investment because the new regime also subjects non-compliance to civil penalties.

While this legislative change is likely to create additional compliance costs, we doubt it will slow foreign investment. However, if the Government choose to adopt a heavy hand on the issuance of fines for non-compliance, this could conceivably impact on Australia's reputation as an easy jurisdiction in which to do business.

8 ACCC proposing major merger law reforms

What is happening?

The Chair of the Australian Competition and Consumer Commission (**ACCC**), Gina Cass-Gottleib, recently characterised the current merger regime as 'no longer fit for purpose' and in need of major reforms.

Cass-Gottleib described the current merger regime as a 'voluntary and enforcement-based' model. Section 50 of the Competition and Consumer Act 2010 (Cth) (**CCA**) prohibits mergers that will likely substantially lessen competition. However, given the inherent uncertainty of the future and the dynamic nature of markets, there were often significant challenges when it came to establishing a breach of section 50 with certainty.

Merger parties are not legally required to notify the ACCC of their proposed mergers nor are they required to obtain clearance from the ACCC prior to completing the merger process.

Currently, where a merger is deemed anti-competitive by the ACCC and the parties do not withdraw or modify transactions, the ACCC must seek intervention from the Federal Court to prevent or unwind the merger.

The ACCC have proposed a formal clearance model where they will implement mandatory notification of mergers above specific thresholds, suspension of transactions without ACCC clearance, and upfront information requirements. The ACCC suggested that the threshold determination for mandatory notification requires careful consideration that can be based on various factors such as the size of the proposed transaction or the business being acquired.

Under the proposed reform, non-contentious transactions can apply for a notification waiver. Where this waiver is granted, the merger can be dealt with expeditiously without a full formal application. The majority of proposed merger transactions are expected to be handled in this way.

What do we expect going forward?

Given the Federal Government has indicated its support of the ACCC's proposed merger law reform, it is likely that the merger regime currently in place may be amended in the near future with more restrictive requirements.

Reform of this kind could place the ACCC in a more central position to Australian M&A while bringing an increase in costs for parties involved. This proposed new process could delay the completion of some transactions, including those that would otherwise be relatively simple transactions.

Key takeaways

- **Board pushback** will be ongoing until companies concede to a new market reality or share prices increase.
- **A move towards renewable energy** and related infrastructure will provide impetus for further deals where ESG is a driving factor.
- **We expect offers to be structured as concurrent schemes** and takeover bids so as to retain the advantages of a scheme but retain flexibility in a competitive scenario.
- **It is vital to disclose all relevant information**, including any conflicts of interests and associated risks, to enable target company shareholders to appropriately assess the merits of takeover bids.
- **We expect PE to remain interested in acquisitions** via the publicly listed market.
- **The long-term returns** of private assets mean super funds are open minded when it comes to future privatisation opportunities.
- **Changes to Foreign Investment Review Board requirements** commencing 1 July 2023 may influence future foreign investment activity.
- **The current merger regime may be amended** in the near future and may include more restrictive requirements.

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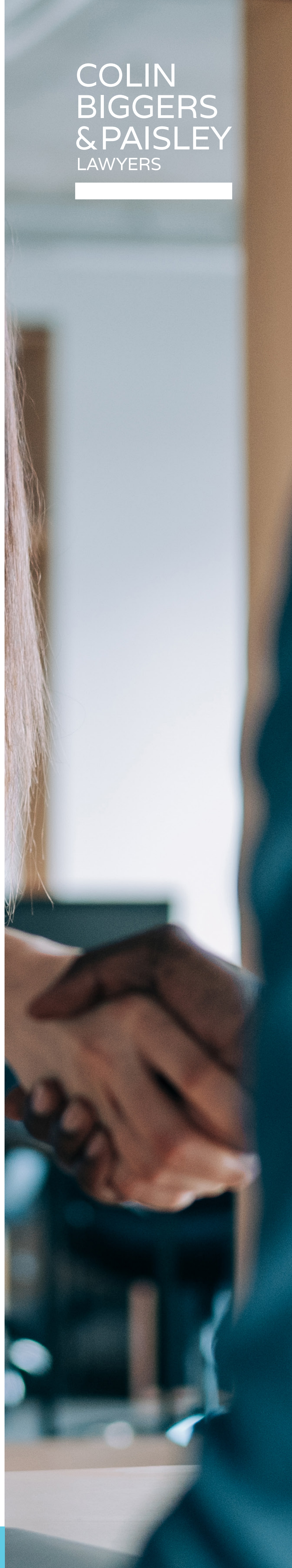

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