Russell McVeagh

M&A Trends for 2019

February 2019

Executive Summary

In February 2018, we published a summary of the M&A trends we had observed over the prior 3 years, and made a number of predictions for 2018. In this update, we summarise what occurred in 2018, test whether our predictions were accurate and consider what we can expect to see in 2019.

2018 was a strong year for M&A in New Zealand, with 176 deals, worth a combined NZ$7.126 billion, being announced in the 9 months to 30 September 2018. This represented a 172% increase in deal value, and an increase of approximately 16% in transaction numbers[1]. While figures for the full 2018 calendar year are yet to be released, activity was very high in the last quarter of 2018 and we expect this trend to have continued for the full year.

On the whole, our predictions for 2018 eventuated. Looking forward to 2019, the key trends we see are an increase in non-bank lending, the continuation of private equity led transactions, take private transactions remaining popular, and (possibly) a general reduction in offshore interest in agricultural assets.

[1] Source: Thomson Reuters.

Russell McVeagh

A Look Back At Our Predictions For 2018

COMPLETION ACCOUNTS VS LOCKED BOX

OUR PREDICTION: We predicted, at the start of 2018, that, while completion accounts would remain the preferred completion mechanic (enabling a "true" picture of a business with exact figures as at completion), the locked box mechanism (effectively a fixed price deal) would continue to rise in popularity.

WHAT HAPPENED: In 2018, we saw a general increase in the number of deals (on which Russell McVeagh acted) undertaken on a locked box basis, with the mechanism being championed by both sellers and buyers. That said, the mechanism appears to remain (relatively) underutilised when compared to international markets and we would expect utilisation rates to increase as market participants become more familiar with the pros and cons, and the complexities, of the locked box mechanism.

TAKEOVERS VS SCHEMES OF ARRANGEMENT

OUR PREDICTION: We predicted that schemes of arrangement would become a much more popular mechanism to take a public company private (when compared to the "traditional" Takeovers Code process). This is due to the flexibility and additional certainty that schemes afford as well as its relatively lower overall acceptance threshold of 75% to achieve a full takeover, when compared to the 90% acceptance level for a takeover offer.

WHAT HAPPENED: There were a significant number of take private transactions completed or launched in 2018. In total, there were 5 take private transactions completed, with 2 of those being undertaken by way of scheme of arrangement (with two additional schemes announced late last year, TradeMe and Methven, that are yet to complete). Given prevailing market conditions, we think that this trend will continue through 2019 (see below).

W&I INSURANCE

OUR PREDICTION: Given the added comfort provided by warranty insurance (otherwise known as "W&I insurance") and associated benefits (such as removing tension between purchaser and vendor, where the vendors retain a stake in the target or continue as senior management), we expected to see warranty insurance become more popular (particularly on large transactions) in 2018. We also considered that warranty insurance would start to be used more in schemes of arrangement (particularly given the general increase in the popularity of schemes).

WHAT HAPPENED: Warranty insurance continued its rise in popularity. According to Aon's global M&A Risk in Review report (released in late 2018), from 2016 to 2017 there was a 34% growth in the number of deals insured (and a 96% growth over the period 2014 to 2017). This is consistent with the growth in warranty insurance that we have seen (and continue to see) in recent transactions.

ANTI-CORRUPTION/ANTI-BRIBERY AND CYBER-SECURITY DUE DILIGENCE

OUR PREDICTIONS: We predicted a general increase in the focus on anti-corruption/bribery due diligence, albeit limited to transactions involving UK and US shareholders due to the extra-territorial application of anti-corruption/bribery legislation in these countries. We also predicted an increase in the extent of cyber-security due diligence, albeit largely driven by the specific sector the target operates in.

WHAT HAPPENED: While we saw a slight increase in the focus on anti-corruption/anti-bribery and cyber-security due diligence, this sort of due diligence focus was certainly not as prevalent as expected. Going forward, we do expect an increased focus on these issues although, as noted in our 2018 report, we expect this to be largely limited to US and/or European purchasers. In addition, given the recent implementation of the EU General Data Protection Regulation, we would expect an increased focus during due diligence on target company compliance with those requirements.

PROPRIETARY/BI-LATERAL DEALS

OUR PREDICTION: We expected purchasers to continue to pursue proprietary deals in 2018, albeit with the demand for high quality assets likely to encourage more tender/auction-type processes on the sell-side.

WHAT HAPPENED: It seems, at least anecdotally, that a large number of deals undertaken last year were done so on a bi-lateral basis, as purchasers sought to reduce competition for assets. That said, the majority of high value assets that were divested last year were done so through a competitive process which, for the large part, appear to have yielded good results for sellers. We expect this general trend (of buyers seeking proprietary deals and sellers seeking a competitive process) to continue.

Predictions for 2019

INCREASED GLOBAL UNCERTAINTY

Global growth is expected to slow in 2019. International trade and investment have softened and downside risks have increased, including escalating trade tensions and geo-political uncertainty. The Reserve Bank of New Zealand said this month that this slowing in momentum is expected to weigh on growth in New Zealand. In particular, we expect that the slow-down in GDP growth in China, Europe and Australia will have ripple effects that impact the New Zealand economy (particularly our export industries). While these macro-economic factors are tempered by our Government's current fiscal policy, including increased spending on hospitals, housing and transport infrastructure, the overall outlook is uncertain which is a key reason New Zealand's business confidence remains lower than in 2018.

This increased uncertainty will likely impact M&A activity which will soften as 2019 continues. Further, given the expected slow-down in growth, we expect demand to decrease for businesses in growth-sensitive sectors (such as technology) and demand to increase for businesses in recession-resilient sectors (such as food and beverage and infrastructure).

INCREASE IN NON-BANK LENDING

We expect to see non-bank lenders competing strongly with traditional banks to finance private equity led M&A in the year ahead. Non-bank lenders have been a key component of the larger offshore acquisition finance markets for many years. However, increased regulatory scrutiny and capital constraints facing traditional banks have provided a significant boost for non-bank lenders in Australia in recent times. We expect to see credit funds from Australia and further abroad to look for financing opportunities on this side of the Tasman in the months ahead. Already this year, Australian-headquartered credit fund Tanarra Credit Partners has opened an office in New Zealand. We expect to see more credit funds from Australia and further abroad to look for financing opportunities on this side of the Tasman in the months ahead.

For private equity, non-bank lenders can present a compelling financing alternative to traditional banks – often supporting higher leverage structures with minimal amortisation and less restrictive operating covenants. The trade-off between increased flexibility and price will remain front-of-mind when private equity sponsors decide which route to go down.

The growth of the non-bank lending market also presents an opportunity for traditional banks to partner with non-bank lenders – with traditional banks providing revolving facilities (on a super senior basis) and non-bank lenders providing the core term debt. There have only been a small number of these structures to date in New Zealand, but we expect more on the horizon.

CONTINUATION OF TAKE PRIVATE TRANSACTIONS

Due to the somewhat late stage of the economic cycle, strong overseas demand for growth opportunities, the relatively weak(er) NZ dollar, and the fundraising levels achieved by private equity sponsors, we expect the recent surge in take private transactions to continue. Already, there are five take private transactions that have been announced in late 2018 or early 2019, and which are yet to complete (or which completed early this year). Listed issuers (particularly those with open share registers) and consumer facing businesses should have a takeover response policy so that they are well prepared to deal with formal and informal approaches from prospective suitors. On average we are observing takeover premiums at around 27% of the pre-announcement price for mature businesses, but the individual premiums can significantly depart from this average. We also hope to see some IPOs later in the year to at least partially offset the significant reduction in the number of companies listed on the NZX.

REDUCTION IN OVERSEAS INTERESTS IN AGRI-BUSINESS

The Ministerial Directive Letter, issued to the Overseas Investment Office (OIO) in late November 2017, has had a significant impact on the way that the OIO assesses applications by overseas persons to acquire interests in rural land. The flow-on impact of that started to materialise in 2018, with few farm land or rural land acquisitions being approved by the OIO (in 2018, approximately a dozen consents for the acquisition of agricultural land were issued, out of a total 96 consents granted in 2018, with 3 consent applications for the acquisition of agricultural land being declined - compared to approximately 34 agricultural land consents (out of 97 total consents) issued in 2017). Although it is difficult to tell how many applications have actually been declined by the OIO (as applicants typically withdraw their application before the OIO issues their final decline decision), the fact that few rural land consents have been issued indicates that there has either been a reduction in the number of rural land acquisitions (conditionally) made, or an increase in the number of consents declined (or both). It is possible that, as the true impact of the Ministerial Directive Letter takes hold, overseas investors may be less willing to go through the process of acquiring rural land given the uncertainty of the consenting process, particularly where that land is currently used for productive horticulture or agriculture purposes and is effectively fully utilised (that is, there is minimal room left to increase productivity or undertake developments).

That said, we think there will be a general increase in demand for businesses which service or participate in agricultural industries without reliance on large tracts of land.

PRIVATE EQUITY RUN CONTINUES

New Zealand, Australian and offshore private equity have been extremely active in New Zealand in 2018, both on the buy and sell side. With debt funding remaining relatively cheap, and private equity funds still with significant volumes of committed (but uncalled) capital at their disposal, we expect private equity to continue to be acquisitive in New Zealand in 2019 and beyond (in Australia alone, 6 new funds totalling AU$5 billion were raised in 2018, a fair proportion of which we can expect to see deployed in New Zealand). Further, a number of portfolio entities owned by New Zealand private equity are likely to come up for sale (having been held for a considerable period), with Australian and offshore private equity often a natural buyer for some of those assets (as has been seen in numerous transactions in the past 24 months or so).

W&I INSURANCE

As noted, the uptake in warranty insurance has continued over the past 12-24 months, with the solution regularly being used in New Zealand transactions. We expect this trend will continue, as more Asia based funds and Asian corporates become familiar with the product. That said, we are beginning to see insurers carve-out some key risk areas (for example, holiday pay miscalculations) and, if that trend continues, the utility of W&I insurance may begin to be called into question, or used in conjunction with other security (for example, targeted escrow arrangements, which we are starting to see more regularly).

Sectors of focus

While difficult to predict, in our view the sectors which will command attention this year include:

- Financial services, particularly as the impact of the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry begins to be felt on this side of the Tasman.

- FMCG, following on from some strong FMCG investments of late.
- Infrastructure, as investors look to a steady income stream.
- Agri-business, especially if investors pivot away from agricultural land assets to other agri-businesses as a result of the impact of the OIO changes.

Some of our deals from 2018

Clients need legal advisers with agility and expertise as they work through complex M&A deals. Our team provides the corporate advisory, finance and tax knowledge our clients need, having advised on some of the biggest M&A transactions in New Zealand and further afield, acting on takeovers (friendly and hostile), private company and private equity M&A, contested bids and tender processes, 'distressed M&A' and business restructuring. In 2018, we acted for:

- Pacific Equity Partners on their sale of Manuka Health New Zealand
- The Riverside Company on their acquisition of the Hiway Group from Direct Capital
- Pacific Equity Partners and Intellihub on their acquisition of Metrix from Mercury Energy
- Bounty Fresh on their takeover of Tegel Foods
- Lion on their acquisition of Havana Coffee
- The Riverside Company on their sale of Simcro to Datamars
- CHAMP Private Equity on a confidential transaction
- Keppel Infrastructure Trust on its acquisition of Ixom
- Acted on the sale of IVHQ to Mercury Capital
- Daiken on their acquisition of Dongwha New Zealand
- Pacific Equity Partners on their acquisition of Evolution Healthcare
- The Carlyle Group on the New Zealand aspects of their acquisition of Accolade Wines
- Emergent Cold on its acquisition of Polarcold from Scales
- Pencarrow on their investment in The Dairy Collective
- Lion on their acquisition of Harringtons Breweries
- Fidelity Life on NZ Super Fund's $100 cornerstone investment
- Heartland Bank on its demerger by way of scheme of arrangement
- Manuka Health on their acquisition of Neuseelandhaus GmbH
- Origin Energy on the sale of its upstream oil and gas assets in New Zealand to Beach Energy
- Acted for Infratil on the sale of NZ Bus to Next Capital

Authors

Ben Paterson
PARTNER

EMAIL ben.paterson@russellmcveagh.com
DDI +64 9 367 8334

David Weavers
PARTNER

EMAIL david.weavers@russellmcveagh.com
DDI +64 9 367 8165

Further Information

Please get in touch with our team if you would like to discuss:

Ian Beaumont
PARTNER
ian.beaumont@russellmcveagh.com
P: +64 9 367 8302

Liz Blythe
PARTNER
liz.blythe@russellmcveagh.com
P +64 9 367 8145

Deemple Budhia
PARTNER
deemple.budhia@russellmcveagh.com
P +64 9 367 8335

Pip Greenwood
PARTNER
pip.greenwood@russellmcveagh.com
P +64 9 367 8040

David Hoare
PARTNER
david.hoare@russellmcveagh.com
P +64 9 367 8343

Tom Hunt
PARTNER
tom.hunt@russellmcveagh.com
P +64 4 819 7519

Mei Fern Johnson
PARTNER
meifern.johnson@russellmcveagh.com
P +64 4 819 7378

Dan Jones
PARTNER
dan.jones@russellmcveagh.com
P: +64 9 367 8410

Guy Lethbridge
PARTNER
guy.lethbridge@russellmcveagh.com
P +64 4 819 7538

Ben Paterson
PARTNER
ben.paterson@russellmcveagh.com
P +64 9 367 8334

John Powell
PARTNER
john.powell@russellmcveagh.com
P +64 9 367 8303

David Raudkivi
PARTNER
david.raudkivi@russellmcveagh.com
P: +64 9 367 8344

David Weavers
PARTNER
david.weavers@russellmcveagh.com
P +64 9 367 8165

Joe Windmeyer
PARTNER
joe.windmeyer@russellmcveagh.com
P +64 9 367 8237

Lance Jones
SPECIAL COUNSEL
lance.jones@russellmcveagh.com
P +64 9 367 8408

Joanna Khoo
SPECIAL COUNSEL
joanna.khoo@russellmcveagh.com
P +64 9 367 8229

Gareth Worthington
SPECIAL COUNSEL
gareth.worthington@russellmcveagh.com
P +64 4 819 7302

Hamish Beckett
SENIOR ASSOCIATE
hamish.beckett@russellmcveagh.com
P +64 9 367 8197

Dominic Rowe
SENIOR ASSOCIATE
dominic.rowe@russellmcveagh.com
P +64 4 819 7329

Isaac Stewart
SENIOR ASSOCIATE
isaac.stewart@russellmcveagh.com
P +64 9 367 8058

Please see **russellmcveagh.com** for further information.