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HD **Roundtable Australia report 2014: Strong ECM volumes to continue**

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Equity dealmakers talk about the healthy pipeline for IPOs, placements and block trades at a roundtable sponsored by Allens.

Q: Mixed IPO performance hasn't dampened appetite for new listings in Australia. Does this suggest we are experiencing a particularly buoyant period?

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A: Mark Warburton: Investors haven't really complained much about where IPOs are pricing. Other than a few notable exceptions, those IPOs that traded down after listing have only been slightly down, and many are now back above IPO price. The market is producing some good quality deals, and investors remain open to new offerings.

Dane FitzGibbon: There have been some cases of recent IPOs where aftermarket performance has been underwhelming, but this has largely been due to certain case-specific facts. Generally speaking investors are having a good experience with their IPO investments. The market is in a sensible place in terms of issuance quality and valuations, and part of our role is to make sure vendors' expectations are reasonable and deals are being priced sensibly.

Adam Lennen: If you look at the average performance of IPOs over Adollars 100 million this year, they are up approximately 9% since listing and the bigger deals have traded particularly well.

Q: Do you expect current strong volumes to continue?

A: Lennen: The outlook for IPOs is generally positive, but a lot of companies are running dual-track processes as there is strong competition from strategic buyers. We expect large IPO volumes, however there will be minimal change to overall equity invested in the market as these volumes are likely to be offset by takeover activity. So while the Healthscope IPO raised Adollars 2.3 billion, this was offset by the Adollars 2.3 billionAurora Oil & Gas takeover.

Bryce Thompson: M&A activity also presents an opportunity for equity capital markets, as buyers look to fund their acquisitions through secondary capital raisings. As yet, we haven't seen a large number of such transactions, but the potential is there, especially as domestic acquirers become more active.

Q: Will the market support fund raisings for acquisition purposes?

A: FitzGibbon: M&A related equity raisings will be well supported by the market if they are being done for the right strategic reasons and on the right financial metrics. The limiting factor on more activity at the moment is primarily the confidence in the boardroom to be pushing the button on acquisitions.

Hamish Whitehead: Transurban's recent Adollars 2.7 billion placement and rights issue is a good example of how much liquidity there is in the equity market for acquisition finance. So capacity isn't an issue. We also believe M&A volumes are likely to increase in coming months Australian companies are carrying healthy balance sheets. Average gearing levels stand at 30%, compared to historic levels of 50%, so there is a feeling among board members and management that they can afford to take on a bit more leverage.

Q: Staying with the secondary markets, what can we expect from block trades?

A: Thompson: The most certain source of secondary activity over the next 18 months is likely to be block trades, owing to the number of private **equity** exits executed in the past year. These blocks are rolling off escrow on a six monthly basis, and some of the private **equity** firms that own these blocks may not be long-term holders of listed assets.

FitzGibbon: There is a series of escrow restrictions about to roll off. Obviously no vendor is going to show their hand to the market before they sell, but just by applying reasonable probabilities you know the aggregative block volume in the second half of the year should be material.

Warburton: The real flows could start as early as next month after reporting season with several **billion** dollars worth of stock coming out of escrow. Whether the private **equity** firms will be ready to exit based on current prices is still undetermined.

Sean Walsh: We also saw the Shell/Woodside block earlier this year and we expect there could be further sizable block trades driven by offshore investors monetizing assets in the Australian market in the second half of 2014. Conditions for block trades are very good - valuations are high, volatility is low, investor appetite for liquidity is strong and, in the case of offshore vendors, the Australian dollar remains above most long-term forecasts.

Q: Could we see more demergers, such as Woolworth's spin-off of SCA Property?

A: Julian Donnan: There is a real opportunity to tap different investor classes by hiving off a dedicated business from a larger conglomerate. It is easy to sell a story around growth, or remodelling a business. This is driving client preferences.

John McLean: Capital tends to flow towards efficiency, so if there is a way of creating a more efficient capital structure for a division or part of a business then the market is likely to support that. But it isn't always easy to predict where spin-offs might exist.

Thompson: Recent spin-offs have typically involved a geographic demerger, for example an Australia-based set of assets from a larger global business. This has been one driving principle behind deals for Westfield, News Corp and Genworth, for example. The other trend has been companies separating out large capital-intensive property portfolios sitting on their balance sheets, for example SCA.

Q: Have there been any recent innovations in the way IPOs are being structured or distributed?

A: Lennen: Yes, innovation is active in this market, whether it is the use of front-end structures, back-end structures, cornerstones, pre-commitments, underwriting or retention ranges.

McLean: We have also seen a resurgence of greenshoes in some situations.

Warburton: The recent IPO of Healthscope had a major cornerstone tranche, which hasn't been seen in this market before. After the Ozforex IPO last year there was a lot more front-end bookbuild or club-type deals and cornerstones were a natural progression. This innovation is being driven by dual-track processes - you need to be competitive against trade options and a back-end bookbuild doesn't cut it.

Lennen: The Healthscope deal was bespoke because the vendors were running a multi-track **sale** process and wanted a high level of certainty from the ECM market. The cornerstone element of this transaction was different from the Asian style structure. In Asia, cornerstones pre-buy and are publicly disclosed in the prospectus. Here the cornerstones had made early commitments but there are different disclosure requirements.

Q: Have you seen a change in the type of investor buying Australian equities?

A: Thompson: There has been increased participation in the market from Asian funds. More generally, we have seen a willingness from a range of institutions to offer pre-commitments and take extended periods of market risk while the deals are being put together. The other trend is an increase in appetite from New Zealand funds for ASX-listed equities.

Warburton: In many ways New Zealand accounts have overtaken Singapore in terms of demand. And there are always boutiques spinning out of the bigger firms too.

Whitehead: Generally there is more interest in Australia from offshore accounts despite the relatively high dollar and the downturn in the commodities cycle. Domestically we have seen a shift in the way industry superannuation funds are managing their money, with many bringing their local equities mandates in-house. This has resulted in an increased appetite for IPOs as in-house analysts do the number crunching on individual deals and the funds invest on their own behalf.

Q: Do you expect to see a rise in the number of dual-listings on the ASX, or overseas companies choosing the ASX as their primary exchange?

A: Donnan: The ASX has released guidance notes to streamline the process for dual listings and the paperwork has been minimised. We are hoping this will generate a lot more interest from overseas companies looking for a place to list.

FitzGibbon: SpeedCast listed on the ASX just yesterday. This business is headquartered in **Hong Kong** with a market cap of circa Adollars 250 **million** and a strong and broad Asia-Pacific revenue base. The decision to list here was based in part on Australia's deep universe of mid-cap fund managers. There are many businesses with Asia-Pacific **operations** that fit into the mid-cap category, and there has been a rise in the level of interest in the ASX market from these types of companies.

Warburton: I agree we could see a reasonable rise in foreign tech listings, partly due to a number of recent high multiple listings from growth issuers like online companies and healthcare companies, rather than Australia's usual resources stocks or property trusts. Singapore is not a natural market for a lot of these high-growth companies because it is more of a yield market, so there is the potential for the ASX to become a regional tech hub.

McLean: I expect overseas issuers will be attracted to Australia because of the ability to execute a deal of substantial size. Some of our IPOs and placements are large relative to global standards.

Q: Is there a deep pool of comparables in Australia to help investors make decisions about pricing?

A: Walsh: Typically there is at least one close comparable **company** or small number of comparables to guide pricing. However, in the event there are no relevant comps, market multiples become increasingly important along with other valuations techniques. Offshore comparables are generally considered to be a useful secondary cross check for investors.

Lennen: When QR National floated in November 2010 there were no other rail comps in the market, which is why international investors with an understanding of the sector led the charge on this deal. Domestic investors bought in the aftermarket when they saw the shares perform well.

Q: Does Australia's market suffer from indigestion? Once a number of companies in the same sector have issued, does interest wane?

A: FitzGibbon: We have not come near to hitting any volume capacity limits. The only issue has been getting mind-share from institutional investors when they have a large number of potential deals in front of them. Asking them to take a meeting and do a little bit of work around the **company** can be harder in these instances.

Warburton: The market certainly does benefit from taking a breather every now and then. There was a bit of general indigestion around July this year, for example, leading into reporting season, and investors stepped back a bit. Come September/October I expect they will be fully engaged again.

Robert Pick: We tend to find the first asset in a category that comes to market is the best quality asset. By the time the third or fourth issuer comes to market the quality of the asset is reduced and this is when investors get sceptical about what is on offer.

Thompson: Capacity isn't a problem in this market. Gross issuance is still fairly low as a percentage of the overall market, and we have a huge pool of superannuation savings looking for a home in domestic equities. That's one reason why companies can achieve a premium on their listings on the ASX.

Q: The current inquiry into Australia's financial system has identified the marketing of hybrids to retail investors as a potential concern. Do you expect rule changes to follow?

A: Thompson: Hybrids issued by financial institutions trade well, but there hasn't been a deal in the corporate space for some time. There were a few corporate deals in 2012 but issuance has now died away, partly due to a change in Standard & Poor's treatment of the **equity** credit on these instruments. We could certainly see a drop in the issuance of hybrids if the regulator steps in and changes the way these securities can be distributed.

Donnan: The UK regulator last week put a 12-month ban on the distribution of bank hybrids to retail investors and local market observers have been watching this move closely to see if there are implications for Australia. The Australian Securities and Investments Commission has been concerned about the marketing of these instruments for some time, but we feel the banking sector here is a lot healthier than in other countries, and there has been a real push to improve education around these products. We don't expect distribution rules to change.

Q: There has been a number of large infrastructure assets sold to fund-led consortiums in recent months. As more privatisations occur, do you see an opportunity for these assets to be sold to public equity investors?

A: Thompson: There are opportunities, yes, but it remains difficult for the listed equity market to compete in the infrastructure space because there is so much capital in the unlisted market and cost of capital for these investors is very low. On a case-by-case basis there will be some opportunities for the listed market, such as the forthcoming listing of Medibank.

Lennen: Public policy is a key issue here. In New Zealand, the government wanted to give local investors more investment choice, and that's why it sold Mighty River Power, Meridian Energy and Genesis through the public markets.

FitzGibbon: Minority sell-downs may also lend themselves to the public markets because they may be less attractive to trade buyers. If a government decides to retain a material portion of an asset then the part they are selling could be taken to the listed market.

Q: What are the biggest risks to the current buoyant sentiment around the equity markets?

A: FitzGibbon: Historically, sentiment has changed when retail investors have become more cautious, or when there has been a few poorly received private equity exits. But, right now, the biggest risk to sentiment is the changing geo-political situation. This could have a broader impact on risk appetite that will change trading valuations and IPO discounts etc. On the whole we expect to see a strong second half in terms of equity market conditions and ECM activity.

Lennen: Short-term blips in sentiment occur when one or two deals trade poorly in the aftermarket or they fail to execute at all. But these blips tend to pass quickly. It is the macro shock events that really drive activity levels.

Walsh: Valuations remain well above long run averages and while some of this may be explained by lower equity risk premia, at some stage the equity market will look for strong underlying corporate earnings growth to support the current trading multiples. That said, our view is that equity market conditions will remain solid throughout 2014.

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