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HD **M&A Trends Australia Report 2014: Fishing for growth**

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Australian CEOs are on the lookout for deals, while juggling their fear of overpaying with a fear of not deploying money.

After years of cost-cutting Australian companies are finally putting their strong balance sheets to work, leading to a flurry of mergers and acquisitions.

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The pickup in deals is being driven by a confluence of cheap access to finance, strong interest from overseas buyers, new funds raised by private **equity** firms and a need for **company** executives to find new sources of growth.

A Deloitte survey of 50 Australian chief financial officers conducted in late June found 60% planned to pursue potential mergers and acquisitions over the next 12 months, compared to 54% in the prior survey.

'With market conditions strong, and the capital markets open to both investment grade and sub-investment grade investors, M&A volumes (in Australia) are already approaching full-year 2013 levels,' said Kelvin Barry, joint head of advisory at UBS in Melbourne.

According to Dealogic, 856 M&A deals worth dollars 70 **billion** were completed in the first seven months of 2014, making it the strongest first half in three years. Five transactions were worth more than dollars 3 **billion** compared with only one in the same period last year. The busiest sectors were **energy** and power, real estate, infrastructure and healthcare.

Jake Haines, managing director at private **equity firm**Pacific **Equity** Partners, points to a marked change in buyer appetite and vendor willingness. 'There was a period of time where there was no real conviction from boards and (chief executive officers),' said Haines. 'Now they are more prepared to commit to a strategic direction. **Business** confidence has picked up and vendors see an avenue to liquidity at attractive valuations.'

It is a sellers' market and the presence of offshore buyers is helping to bid up prices. In May, a consortium of Hastings Funds Management and **China** Merchants **Group** beat four other parties to pay a multiple of 27x earnings for Port of Newcastle, while in January this year, a three-way takeover battle for Warrnambool **Cheese** and **Butter** saw Canadian **company** Saputo increase its initial offer by 35% before finally securing the asset.

Valuations in check

Despite these heavily contested deals, Simon Haddy, a partner at law **firm** Herbert Smith Freehills, believes prices are not overblown. 'Buyers are always balancing their fear of overpaying for assets with their fear of not deploying money,' said Haddy. 'Yes, there are some healthy prices being paid for a number of assets where there is strong competitive tension, but in general prices aren't over the top.'

Haines at PEP also says M&A valuations are in check now that the market for initial public offerings has shed some of its froth. 'At the back end of last year pricing was inflated as the IPO market provided an elevated shadow market,' he said, pointing to travel insurance **company** Cover-More which listed in December last year at a price of 23.1 times forecast 2014 profits and has since traded flat. Shares in electronic retailer Dick Smith have also underperformed after its December IPO which valued the company at Adollars 520 million, a more than 400% increase on a year earlier.

PEP is actively putting capital to work and belongs to a small club of mid-sized, home-grown private equity firms that includes Champ, Archer Capital and Quadrant. This group of four plays in the space below international funds like TPG and Kohlberg Kravis Roberts (KKR), which also have money to deploy in Australia. In June, TPG purchased the property arm of contractor UGL for Adollars 1.2 billion (dollars 1.12 billion), while KKR is still hoping to pick up Treasury Wine Estates, increasing its offer for the beleaguered winemaker to Adollars 3 billion in early August.

'These bigger firms may do one deal a year and focus on the larger transactions, whereas the mid-market players have a broader target,' said Haines, estimating that Australia's four principle domestic players have around Adollars 5 billion in equity capital to be spent. 'We are as busy as we have ever been. In the past 12 months we have returned Adollars 2.7 billion to investors and I expect this pace of activity to continue.'

Myriad funding

A key driver of volumes this year has been access to open and liquid financing markets, both at home and overseas. Vendors are able to run parallel processes; choosing between selling to a strategic buyer, a private equity firm or through the public markets. Buyers, meanwhile, can fund their acquisitions with a combination of cheap debt and readily available equity capital.

Insurance Australia Group used a mix of funding when it purchased Wesfarmers' insurance underwriting business in June, raising Adollars 200 million from existing investors via a share purchase plan, Adollars 1.2 billion in an equity placement and Adollars 300 million in subordinated debt. The fully underwritten placement priced at a 4% discount to its closing price at the time.

'The quantum of capital available and the cost of that capital means buyers have a greater propensity to bid aggressively,' said Barry at UBS.

Some of the more aggressive bids have come from overseas. In two instances, foreign buyers have trumped local competitors by making all-cash offers.

In May, Cheung Kong Infrastructure from Hong Kong made a last minute counter-bid to APA Group's Adollars 2.2 billion offer for gas distributor Envestra. Independent directors immediately put their weight behind CKI's all-cash offer, preferring it to APA's mainly scrip deal, and welcoming the 8% increase in price.

Strong capital markets are also fuelling a burst of outbound M&A transactions - a segment that has traditionally lagged inbound activity.

Thomson Reuters reported a 260% rise in outbound M&A in the first six months of this year, the highest first-half period since 2010. Two of the biggest deals were Poker machine manufacturer Aristocrat Leisure's dollars 1.3 billion acquisition of American rival Video Gaming Technologies, funded with a Adollars 375 placement to local shareholders and dollars 1.3 billion in debt from the US public Term Loan B markets. The placement closed on July 7 at a 2.4% discount to the stock's closing price the previous day.

In another US target deal, Australian protective clothing and condom maker Ansell bought Illinois-based glove maker BarrierSafe for dollars 615 million in January this year, raising Adollars 340 million in local equity and dollars 200 million in debt from the US private placement market.

Buoyant markets are changing the way deals are structured. Buyers are using more cash to fund deals, said Nick Sims, head of M&A at Goldman Sachs in Australia. 'This year cash has risen to represent 78% of all acquisition considerations driven by the presence of international acquirers in nine of the 10 largest deals so far this year whose stock may be less attractive to Australian shareholders.'

260% - Rise in outbound M&A in H1 2014

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