HD Top 10 Australian M&A Predictions for 2014

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The results are in - 2013 was another tough year for the Australian M&A market overall. However, despite a sluggish first half of 2013, we saw increased M&A activity in the second half of the year (with three of the biggest M&A deals of the year commencing in that period) with commentators expecting this increased confidence to flow through to 2014.

Set out below are our top 10 Australian M&A predictions for 2014:

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2014 A SOLID YEAR FOR AUSTRALIAN M&A

Arguably, the time is now right for growth through acquisition, which means we can expect to see more transformative deals going forward. We expect the technology, real estate and mining sectors to drive the growth in M&A in 2014.

There are a number of key drivers of M&A activity prevalent in the market which indicates to us that the Australian M&A outlook for 2014 will be stronger. These include:

Stronger balance sheets and excess cash that will need to be used or returned to shareholders.

Interest rates being low with acquisition financing appearing readily available.

The Australian equity market, whilst still being somewhat volatile, is strong.

The new Coalition Government declaring Australia open for business and its commitment to removing "red tape".

Companies that have been focussed on low risk strategies of core business focus, smaller acquisitions and divestments of non-core assets, are now coming out of that cycle and are looking for bigger M&A opportunities to materialise.

AUSTRALIAN FOREIGN INVESTMENT STRATEGY

With the softening of the Australian dollar, the strengthening of the US, UK and Japanese economies and the prospect of the free trade agreement with China being finalised sometime this year, we predict that foreign buyers will continue to contribute heavily to Australian public M&A deal flow in 2014.

The Federal Treasurer's recent foreign investment decision in respect of Archer Daniels Midland's proposed acquisition of GrainCorp and the relaxing of conditions that will allow the Chinese SOE Yanzhou Coal to wholly own its listed subsidiary Yancoal have left some commentators in the market scratching their heads. Whilst the GrainCorp decision should not be perceived as a deterrent for future foreign investment in the agribusiness sector (or other sensitive sectors), it highlights the fact that having an effective FIRB strategy (taking into account the political undertones that drive these decisions) will continue to be of critical importance to the success of inbound M&A investment into Australia.

Whilst investment in Australia's agribusiness sector will continue be a key driver of Australian M&A activity in 2014, the GrainCorp decision along with the planned lowering of FIRB thresholds for foreign investment in Australian land and agribusiness, is likely to result in an increase in agribusiness M&A

transactions being structured as strategic acquisitions of minority interests (with joint venture like implications), rather than as 100% or controlling stakes.

STRATEGIC MERGERS

As a result of the continuing tough market to obtain finance for greenfield projects, in 2014 we expect to see more strategic acquisitions of small-cap companies, or their assets, by established and well capitalised buyers through friendly transactions. For many small-cap companies (particularly in the resources sector), this will be merger by necessity, rather than choice.

USE OF SCRIP AND OTHER CREATIVE CONSIDERATION

Whilst in 2013, cash was the consideration of choice in the majority of public **M**&A deals, as bidder balance sheets and share prices improved, there was a re-emergence of the use of scrip consideration (either 100% scrip or partial scrip) in proposed transactions. We anticipate this re-emerging trend will continue in 2014. In addition, we could see the re-emergence of "earn-out" type instruments, such as the contingent value rights used in Yancoal's **acquisition** of Gloucester **Coal** in 2012, or other creative consideration mechanisms. Nervous bidders may seek refuge in these instruments which ensure the seller remains partially on risk.

DECLINE OF FIRST MOVER ADVANTAGE

While we expect to continue to see recommended offers, as confidence continues to build we can expect to see increasingly competitive bids for strong assets, resulting in diminished advantage to first movers. Prime examples are the competitive bids for Warrnambool Cheese and Butter Factory**Company** and Commonwealth Property Office Fund.

SCRUTINY OF DEAL PROTECTION DEVICES

Given increased bidder competition, there will be continued emphasis on deal protection measures such as exclusivity, matching rights and break fees. However, the comments of Farrell J in the Federal Court in respect of deal protection measures in the Cape **Alumina** Ltd scheme of arrangement in late 2013, in which her honour expressed the view that that target directors need to carefully consider whether accepting arrangements which fetter their ability to exercise their fiduciary duties as part of deal protection measures are consistent with their fiduciary duties, sends a warning that greater legal scrutiny is likely to occur in respect of these arrangements in 2014.

SOFTENING OF THE BEAR HUG

There was a decline in the use of strategic bear hugs by bidders in 2013, as against previous years. Whilst bear hug tactics will remain in the arsenal, we believe that the general strengthening of target **company** balance sheets, coupled with the increasing trend of competition for strategic assets, will result in a continued decline in their use.

**EQUITY** SWAPS

**Equity** swaps will likely remain a feature of the public **M**&A landscape in 2014. The Virgin Australia Holdings decision by the Takeovers Panel, in which DLA Piper played a key role in acting for Etihad Airways, indicates that neither the Panel nor ASIC currently see a need to take a hard-line or lay down new guidance in respect of the use of cash settled **equity** derivatives in transactions with potential control implications. Provided that bidders comply with existing guidance in respect of the use of swaps, we predict that they will continue to be an effective tool used in **M**&A deals in 2014.

SHAREHOLDER ACTIVISM

Shareholder activism in control transactions will become a feature in the 2014 Australian **M**&A landscape. Shareholder interest groups (or individual shareholders backed by those groups) are becoming far more bold in respect of control transactions, including in respect of Takeover Panel applications. The Virgin Australia Takeovers Panel application serves as a reminder that even shareholders with a comparatively small interest in a target **company** have standing to bring Panel proceedings and are willing to exercise that right when they consider the circumstances warrant it.

TAKEOVER REFORM?

Given the focus of the Federal Government on budget and economic issues, we do not expect to see much in the way of takeover regulatory reform emanating from the Government in 2014. Whilst on-going regulatory consideration will be given to the abolishment of the 3% creep provision and the implementation of a UK style "put-up or shut-up" rule, we do not expect any new material developments in the takeovers law, at least for this year.

With increasing activity and improving confidence we believe that 2014 will provide an attractive M&A market for our clients. If you have any questions or queries about an M&A transaction, market trends or strategies, please contact David Ryan, Lyndon Masters or your established DLA Piper corporate lawyer.



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