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HD **Treasury bows to sober reality**

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Brilliant wine is all about the indulgence of the senses to the joyful detriment, sometimes, of a firm grip on logic. So perhaps that is why it seems just that little bit sad that the board of our home of wine icons, Treasury Wines Estates, has bowed to sober rationality in delivering American private equity the keys to due diligence on the basis of the cold hard numbers.

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But, of course, that is the way it is, and should always be, in the life and possibly forced retirement of a public company. Sating emotion does nothing to generate value for the shareholders. And, outside of offering consistently beautiful products, TWE and its antecedents have too often fallen frustratingly short of their owners' financial expectations.

While we haven't always seen eye-to-keyboard with TWE chairman Paul Raynor, he has got it exactly right this time. After rejecting private equity's first pitch of $4.70 a share, the chairman and his board have decided to "engage" after Kohlberg Kravis Roberts and its appropriately named partner in acquisition, Rhone Capital, came back with a $5.20-a-share pitch.

Engagement, in this case, means non-exclusive due diligence. And that, in itself, is just a little win for TWE shareholders. These sorts of private equity bear hugs sometimes end with a period of bidder exclusivity while value propositions are tested.

But in this case the dataroom door remains open to others before (and presumably after) KKR and Rhone go deep and meaningful on the TWE books. This matters because there is just a hint in the way TWE is being priced that says the market may be anticipating that this might yet become a contest.

The price now entertained by KKR and Rhone has very quickly generated a fair weight of opinion that says TWE's brief life as an independent business is about to come to a sudden end. In the end, the only real bones of contention left in the discussion are whether private equity will actually put its price to the TWE board and whether that offer might then prompt some interested bystanders of repute to challenge private equity's death grip.

In the wake of Monday's announcement the market almost immediately bumped TWE shares to $5.17 a share, a mere 3¢ a pop shy of the KKR-Rhone pitch. By the close that had drifted to $5.15 a share.

That says that investors are betting private equity will justify their price, make a firm offer and that it will be recommended by the TWE board.

But drawing conclusions on the discount to the foreshadowed price and what that might say about the potential for a second bidder is a rather less certain pastime.

No, the price did not surge beyond the foreshadowed offer which says that no one is getting too excited yet. But, at the same time, Monday's range reflected a aggressively small discount to private equity's pricing given how long this process could run and the risk of delivery that process necessarily implies.

Then again, it has to be acknowledged that, right from the moment of its independence in May 2011, there has been fairly constant speculation of competitor intent to take out TWE. But, so far at least, none but this pair of value investors have come a-knocking.

The other point to appreciate in thinking through the potential for a contest is that the numbers say private equity has arrived with a keenly pitched offer. Before the KKR's opening gambit of $4.70 back in April, TWE was trading at $3.69 a share and even that represented a challengingly optimistic multiple of 17.5 times historic earnings. The offer that finally opened the dataroom doors is pitched at a pretty keen 24 times multiple over historic numbers and an even more epic 32 times estimates of 2014 earnings.

Then again, some work done by Morgan Stanley back in May would suggest the multiples here are no more than average, based on the last 24 transactions in the sector. That work implied a TWE price of $5.18. Which is near as damn it to where KKR and Rhone have landed.

What we can say for sure here is that private equity seems to be seeing a whole lot of value in TWE that others do not.

On the face of it, the price under contemplation looks pretty toppy and there is every reason to suspect that private equity's optimism is fuelled by discrete certainty about the value of the parts here rather than of the sum.

The potential that TWE is worth more unbundled than together has been obvious, externally at least, for nearly all of the 15 years this wine business has been trying, and failing, to make its pan-Pacific alliance work.

The tale of the tape here is pretty simple. The $US2.9 billion acquisition of Beringer at the turn of the century marked the end of Foster's Brewing Group's $8 billion splurge on growth in wine. KKR and Rhone are offering $3.4 billion ($3.64 billion) for that business. The rest of that value has been burned. Joining this Australian wine business with international aspirations to a US business with an understandably domestic focus has proven a task too far for all who have accepted its challenge.

The most recent victim was the cheerful and well-liked David Dearie, who was summarily dismissed midway through 2013 after the confirmation of an embarrassing $160 million write-down on the US business. This has long been the way at this company. Chief executives come and go at short notice and strategies; structures and staff are routinely redrafted with these changes.

The break-up that saw Carton & United Breweries end up under South African stewardship was supposed to represent a new dawn for the re-branded wine business.

But since being listed as Treasury Wine Estates the new narrative has run pretty true to the old one.

Financial and strategic targets have been set and missed, the people responsible for that have been moved on and shareholders have been presented with new teams and their new plans to finally generate returns from the wine icons that sustain TWE's value.

There is surely more irony than coincidence in the fact that private equity has arrived hard on the heels of new boss Mike Clarke. His first three months at the helm have shown cause for considerable optimism. He has moved to clarify the structure and management of the business, recover lost marketing grunt and even started to listen to the core talent of the business, its winemakers. But, given all goes as expected, Clarke might not even make it to his first annual general meeting.

Mind you, he will do pretty well for himself if that is the outcome. Sensibly Clarke ensured his remuneration package included change of control protections. One of them means that if the business falls before that package is approved at the AGM, his FY15 long-term incentive package will be paid out in full. The LTI maxs out at 200 per cent of his $1.7 million salary.

Meanwhile the early end of another beautiful relationship leaves Roc Oil headed into Chinese ownership and spurned partner Horizon Oil facing the sort of existential crisis that comes from a divorce no matter how civil and predictable.

Having presented the proposed merger of equals with Horizon as a match made in strategic heaven, Roc's board has now decided to throw its support behind a $474 million, all cash, condition-lite offer from Hong Kong-listed Fosun International.

This leaves Horizon looking at a suddenly withered share price and the risk that one of a **group** of potential suitors might end up with discount access to the junior's mooted gas future in Papua New Guinea.

The short form of the logic for the now-abandoned deal was that Roc had strong free cash flows but few growth options and Horizon was long growth but short secure funding.

In this case bluff honesty might prove costly. Roc's decision to please its owners such as Allan Gray's Simon Marais by taking **China**'s cash rather than Horizon's uncertainties has unfortunately exposed the PNG explorer's frailty.

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