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HD M&A market flagging after exciting 2015
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Australia has felt the bite of a serious global cooling.

TD Last year was always going to be a hard act to follow for Australia's mergers and acquisitions landscape: it was a record year for **M** &A globally and the strongest in Australia since 2011.

But not surprisingly, after a swath of major global stockmarkets found themselves officially in "correction" territory - that is, down at least 10 per cent - less than a fortnight into 2016 activity, **M** &A activity has cooled.

According to research **firm** Mergermarket, Australian **M** &A activity cooled in the first quarter of 2016, with 76 deals struck, worth $17.3 **billion** . That represents a 57 per cent decrease by value compared to the corresponding 2015 quarter, when 104 deals were done, totalling $40.7 **billion** .

Worse, the total deal value was heavily propped up by the takeover battle for logistics group Asciano, which at $12.6 **billion** accounted for almost 73 per cent of the Australian deal value.

Inbound activity during the first quarter rose by 17.2 per cent to $15.4 **billion** , says Mergermarket, while outbound activity fell 88.4 per cent, to $1.3 **billion** . Private **equity** buyouts also fell by 88 per cent, to just $173 **million** .

The Australian market was not alone: worldwide **M** &A has been hurt in the opening first half of 2016 by falling **oil** prices, slowing growth in **China** , persistent concerns over the health of the financial sector and the possibility of a destabilising Brexit decision in Britain's forthcoming referendum. Deal volumes and values are well down on the same period last year.

But with low interest rates keeping debt cheap, the Australian currency back to 20-year average exchange rates around the low 70¢ levels, good assets available in sectors such as **energy** , infrastructure and health care, overseas interest in **M** &A opportunities in Australia can only be expected to increase, industry participants say. And the local **M** &A cycle, too, is on the rise.

"Certainly in our space, infrastructure, Australia is seen as a source of good, large deals, good assets, and in particular, a stable regime in which to invest. And the low Australian dollar is certainly helping with that," said Russell Smith, partner at Global Infrastructure Partners, at the recent Deal Advisory roundtable held in Sydney.

Speaking at the roundtable co-hosted by The Australian Financial Review and KPMG, Geoff Hutchinson, managing director of private **equity firm** Pacific **Equity** Partners, said international investors see in Australia a Western country with strong rule of law and a robust growth picture.

"Australia is still growing at about 3 per cent, which is fairly good compared to what growth rates are anywhere else in the Western world. We've got low debt levels, compared to any other Western country, and underpinned by the population growth as well, it's a good environment to invest in, a safe environment to invest in as part of a global portfolio."

And for the strategic investor, it is even more attractive, says KPMG Australia's national head of private **equity** David Willis. The major areas that have seen this have been infrastructure, property, resources and agriculture. Last year, for example, **China** Investment Corporation bought Investa Property Group's portfolio of nine office towers for $2.45 **billion**, in the biggest direct real estate transaction in Australia's history, while the NSW government privatised its electricity transmission network, TransGrid, for $10.26 **billion** through a 99-year lease to a consortium comprising local player Hastings Funds Management, the ASX-listed Spark Infrastructure, the Abu Dhabi Investment Authority, Canada's Caisse de Depot et Placement du Quebec, and Wren House, part of the Kuwait Investment Authority.

"We're obviously seeing big interest from the North American pension funds in our infrastructure assets, and a big inbound thematic from **Chinese** investors - for example [**Hong Kong**-listed] Legend buying 90 per cent of Kailis Brothers' seafood business, and another **Hong Kong company** buying Swisse Wellness - and we've seen **Chinese**/**Hong Kong** companies very active in agribusiness. They're all examples of buyers investing thematically for the long term," Willis says.

And not just investors: trade buyers are also very interested in Australia.

"For all of the same reasons, don't ignore European and US trade players," says Gareth Banks, director at private **equity firm** CHAMP Ventures and chairman of the Australian Private **Equity** and Venture Capital Association Limited.

"They look at Australia for the same reasons. If they're looking to expand, there's a good rule of law, there is a robust economy, there is strong growth rates, there's adjacency to Asia, and good backable teams to run these businesses. Four of our last five exits where we've sold businesses on after building them have been to either European or American trade players," Banks says.

Australia's attributes have seen the nation become very successful in attracting big pools of capital to invest in its markets: sovereign wealth funds, overseas pension funds, **Chinese** companies - to say nothing of the $2 trillion local superannuation pool.

KPMG partner Peter Turner says there is another source of capital keen to play in the local market - large multinationals with very strong balance sheets. "Many of those companies don't want to repatriate cash back to their home countries because of tax consequences. They've got capital, they need to find the next growth opportunity and they've got enormous balance sheets, with cash that they need to do something with," Turner says.

Which leaves the local **M**&A players. "If we look at the local listed market, I think companies for a long period of time have been focused on capital management, and looking in particular at the dividend payout ratios. That's probably been driven by the demand from self-managed super funds for franked dividends," Willis says. "Payout ratios peaked this year at about 80 per cent, and a number have had earnings fall since and have had to cut that. [There has] not been a focus around growth by **acquisition** for all listed companies and I think that may change."

Reunion Capital's Michael Everett agrees. "Post-GFC boards have focused much more on their own balance sheet and their own funding and securing the home turf rather than being too aggressive. But I think you might just see that pendulum shift a bit more towards corporates having to think about using that capital rather than buybacks, to promote that capital into **M**&A that drives earnings and pushes their strategy out," he says.

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