KING&WOOD MALLESONS
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M&A IN THE CITY

2024

Port by Jane Hoggard

WELCOME TO KING & WOOD MALLESONS' SECOND M&A IN THE CITY FOR 2024

In this edition we take you down into the trenches to talk trends and tactics, but also take time to zoom out for a global look at the latest on M&A markets, major themes and the H2 outlook.

Fresh back from NY and the International Bar Association's global M&A conference, Nicola Charlston and Anthony Boogert get together for a podcast chat to compare notes on top dealmakers' views about market movements, sectors to watch, regulatory challenges and the looming US election. They also unpack Morgan Stanley's 'three D's' (deglobalisation, decarbonisation and digitisation) analysis of the megatrends driving dealmaking.

Getting technical and tactical, Antonella Pacitti and Jacob Carmody explore how company listed boards can make competitive tension work for a deal - with a fascinating insiders' take on the top 5 rules for managing interloper engagement – including the billionaire larger-than-life types.

Will Heath, Jason Watts & Genovieve Lajeunesse share valuable lessons for bidders on engaging with a target's major shareholders, with a thoughtful explanation of how Alcoa struck a pivotal pre-scheme deal with Alumina's major shareholder Allan Gray.

As regular readers will know, deal protections are a keen area of interest for this publication – for good reason, as they continue to evolve and grow – in both size and importance. Daniel Natale and Jennifer Cheung have dived deep into the deals data to explore how COVID supercharged the trend towards supersized MAC (material adverse change) clauses. Digesting that mouthful, they ask our favourite question and one you'll find us trying to answer across these pages…

WHAT DOES IT ALL MEAN FOR DEALS?

We have fun searching for the answers, and trust you'll find reading (and listening) both enjoyable and insightful.

IN THIS EDITION

RULES OF ENAGEMENT

Recent reflections on pre-scheme agreements with major shareholders

As the unsuccessful scheme proposal for Origin illustrated last year, it can be tough to acquire an ASX-listed target with a major shareholder.

So, what are the basic rules of the road for takeover schemes? And how do they work in practice?

This note highlights some of the fundamentals from the driving manual for dealing with major shareholders in a target. We then hit the road to review the pre-scheme agreement reached in the recently-proposed acquisition of Alumina Limited (**Alumina**). Transaction details disclosed in the bidder's publicly available filings[1] provide a relatively rare roadmap charting the negotiation of a pre-scheme agreement.

WHAT CAN BE DONE?

It is generally acceptable for a bidder to have confidential discussions with a major shareholder, provided arrangements are in place to avoid inadvertently tripping over takeover and insider trading traps.

There are three key limitations on pre-scheme agreements or arrangements with major shareholders of a target.

1 The bidder must not breach the 20% takeovers prohibition by reaching an agreement or an understanding with a major shareholder to sell voting shares representing more than 20% of the target.

2 The bidder should beware that any shares acquired by it (or its associates) are generally not counted towards the scheme voting tests. As we explained last year, this means that stake-building is less common for schemes than takeover bids, and puts more pressure on the structure of pre-scheme arrangements.

3 Pre-scheme arrangements which seek commitments from a major shareholder (or shareholders) to support or vote in favour of a scheme proposal can conflict with Takeovers Panel and ASIC guidance. In particular, ASIC has warned bidders to exercise caution when inviting major shareholders to make "intention statements" where the makers of the statements speak for more than 20% of the shares on issue.[2]

SHAREHOLDER SUPPORT ESSENTIAL TO SCHEME SUCCESS

A takeover scheme will only be successful if the deal is approved by:

- a majority in number of target shareholders in a class, present and voting (either in person or by proxy); and
- 75% of the votes cast on the resolution.

Bidders considering a takeover scheme must carefully consider their plan to engage shareholders, including any major shareholder who could significantly influence or 'block' the 75% vote requirement.

HOW DID THE ALCOA-ALLAN GRAY AGREEMENT MATERIALISE?

Alcoa proposes to acquire Alumina under a scrip-for-scrip scheme of arrangement, under which Alumina shareholders will receive Alcoa CHESS Depositary Interests (**CDIs**), representing an ownership interest in a share of NYSE-quoted Alcoa common stock. Alcoa will seek a secondary listing on ASX so that the CDIs can be quoted and traded on ASX.

Allan Gray is Alumina's largest shareholder, holding around 20% of Alumina for some time.

The infographic below summarises the key chronology leading to signing of the Alcoa/Allan Gray pre-scheme agreement and the Alcoa/Alumina scheme implementation deed.

KEY EVENTS

October 2023

INITIAL APPROACH

In, Alcoa makes confidential non-binding indicative proposal (**NBIO**) to Alumina offering 0.0242 Alcoa CDIs for each Alumina share. Alumina responds in November that it would require a higher exchange ratio.

December 2023

ALLAN GRAY APPROACH

In early December, Alcoa contacts Alumina's largest shareholder, Allan Gray, to discuss the NBIO on a wall crossed, confidential basis. Allan Gray indicates it would be supportive of the potential transaction.

30 January 2024

FURTHER PROPOSAL

Alumina counter-proposes to Alcoa a fixed exchange ratio of 0.0303 Alcoa CDIs. On 13 February, Alcoa offers 0.0265 Alcoa CDIs. Alumina rejected the new NBIO.

23 February 2024

FURTHER AND 'BEST' PROPOSAL

On, Alcoa delivers a further new revised NBIO for an increased fixed exchange ratio of 0.02854 Alcoa CDIs. Alcoa also delivers Alumina a draft exclusivity and transaction process deed (**Process Deed**). The Process Deed requested a hard exclusivity period of up to 4 weeks to negotiate a binding scheme implementation deed consistent with the new revised NBIO. Alcoa informs Alumina that:

- If the parties can't reach agreement on the Process Deed before 26 February, it would publicly announce the terms of the NBIO indicating that it was the best price (meaning the best exchange ratio) Alcoa was willing to offer
- based on its discussions with Allan Gray, it anticipated strong support from Allan Gray.

26 February 2024

PRE-SCHEME AGREEMENT

Alcoa and Alumina sign and publicly announce the Process Deed. Alcoa and Allan Gray enter into the conditional share sale agreement under which a controlled subsidiary of Alcoa had the right to acquire from Allan Gray up to 19.9% of Alumina shares at a price of 0.02854 Alcoa CDIs for each Alumina share (the same fixed exchange ratio).

12 March 2024

SCHEME IMPLEMENTATION DEED SIGNED

Alcoa and Alumina sign a scheme implementation deed under which Alcoa proposes to acquire Alumina on a scrip-for-scrip basis.

KEY FEATURES OF THE ALCOA-ALLAN GRAY PRE-SCHEME AGREEMENT AND LESSONS LEARNED

The Alcoa-Allan Gray conditional share sale agreement provided Alcoa with a foothold on Alumina shares, as well as transaction support from Allan Gray. The three key elements were:

STRUCTURE

A conditional sale agreement which gave Alcoa a conditional right to acquire up to 19.9% of Alumina from Allan Gray by issuing 0.02854 Alcoa CDIs for each Alumina share, once Alcoa satisfied various conditions including obtaining approvals to list on ASX and quote the CDIs. While these approvals would be obtained as part of the overall scheme process, it is questionable whether they were obtainable on a standalone basis should the scheme not be successful.

LOCK UP

The agreement locked up Allan Gray for a maximum period of three months. This meant that Allan Gray could not deal with interlopers for that period, giving Alcoa a level of assurance that Allan Gray supported its proposal.

TERMINATION

The agreement automatically ended after the three month lock up and could end earlier if (1) a scheme implementation deed was entered into at the fixed exchange ratio and (2) Allan Gray made a public voting intention statement that it intends, in the absence of a superior proposal, to vote any Alumina shares that it has in favour of the scheme.[3]

The Alcoa-Allan Gray conditional share sale agreement was terminated by Alcoa on 20 May when Alcoa published its preliminary proxy on the SEC. Alcoa's preliminary proxy stated that Allan Gray "has confirmed it continues to be supportive of the proposed transaction".

Given the agreement was terminated, Alcoa no longer had a relevant interest in the shares held by Allan Gray nor could there be said to exist any ongoing association. It may have been challenging for Alcoa to continue to hold a lock-up over (and therefore relevant interest in) the Alumina shares held by Allan Gray through to the scheme meeting date as that would have raised questions about the ability of those shares to be voted. Additionally, had Allan Gray made a formal voting intention statement, there might have been a concern as to whether the parties were associates, or at least what ASIC's and the Court's position might have been.[4]

Finally, proposing a pre-scheme agreement is not the only way forward for a bidder to successfully implement a takeover scheme. In addition to the Alcoa/Alumina scheme, 2024 has also witnessed a joint bid for ASX-listed Adbri Limited by CRH and Adbri's major shareholder the Barro Group. These deals should give bidders comfort that there are options for dealing with major shareholders and successfully implementing a takeover scheme.

The views expressed in this note are the views of the King & Wood Mallesons M&A team only and are based solely on publicly available information.

1. The proposed acquisition of Alumina by NYSE listed Alcoa Corporation (**Alcoa**) requires Alcoa stockholder approval under NYSE listing rules. To that end, Alcoa has published a preliminary proxy statement which is publicly available on U.S. Securities and Exchange Commission website. Alcoa's proxy statement summarises certain key events leading up to signing of the scheme implementation deed with Alumina. The proxy statement provides a unique insight into the "how" of the transaction which would otherwise not be made public for a domestic Australian public M&A deal. Equivalent publicly available "how" summaries were published on the Afterpay/Square and Newmont/Newcrest transactions, however, neither of those deals involved complex pre-deal agreements. Our KWM team has had a role on all three deals.

2. Despite ASIC's statement, there are recent examples of schemes involving shareholders who have given voting intention statements in excess of the 20% threshold e.g. Singapore Power, which owned 32.74% of AusNet Services shares, provided a voting intention statement to the target in relation to the successful Brookfield scheme proposal.

3. Upon signing of the Alcoa/Alumina scheme implementation deed, Allan Gray did not make a formal voting intention statement, but rather confirmed that it continued to be supportive of the proposed transaction.
As noted above, the Alcoa-Allan Gray agreement automatically expired after 3 months (at the end of May) and the announcement of its termination of 20 May ended the agreement between the parties.

4. Cf Re Hostworks Group Ltd [2008] FCA 64 at [45].

THREE'S A CROWD, BUT DOES IT REALLY HURT TO HAVE AN INTERLOPER AROUND?

Five ways to make competitive tension work for a deal

Competition in the market for control of a listed company is nothing to be afraid of; quite the opposite. Shareholders ought to benefit from real competition, and both the perception and reality of competitive tension can provide a circuit breaker where there is a value gap (between target and bidders) or a prolonged period in play.

Increased regulatory scrutiny and ensuing deal delays are providing more chances for third parties to present compelling alternatives, especially when market values shift.

But what happens when an interloper - unlisted or otherwise - either doesn't present a competing proposal, or risks derailing the one you have? Listed companies and bidders bound by continuous disclosure and stakeholder expectations face challenges dealing with an interloper not similarly constrained. And what if 'agitation', rather than control, is the interloper's endgame? How do you respond as a listed company board?

This is a not-infrequent scenario in the West. Our private capital landscape has not only the well-trodden trails of private equity, but also, the occasionally steep and somewhat less predictable terrain of family office or 'billionaire' backing. And it can get very hot out there!

Below, we've pulled out the Top 5 rules of interloper engagement and added a note of encouragement when confronting the wallflower interloper.

1
EXCLUSIVITY AND OTHER DEAL PROTECTIONS SHOULD BE DETERMINED BY YOUR DEAL (NOT SOMEONE ELSE'S)

If you have organised a party for two, you have probably agreed exclusivity and other deal protections with the incumbent bidder, and perhaps a chunky break fee if one of you leaves the party early (or doesn't bother to bring any chips!).

It has become common place for the discussion to start with what's 'market' or what your legal or financial advisers – or you – agreed in the last deal.

But perhaps take a pause: any exclusivity and deal protections should be determined by your deal, the competitive dynamic for your company and the characteristics of you as target and that bidder. This better preserves competitive tension and the ability to adapt to changing market and control dynamics - while preserving the availability of a compelling proposal in the hand.

If you're the interloper, expect to challenge these protections to engage with the target company effectively. The first thing you're going to attack – and seek to challenge and even dismantle - are any fetters on the target's ability to properly engage on your competing proposal or legitimate concerns.

As a target, remember that securing a deal for your shareholders does not mean being disproportionately beholden to any deal or fettered in your ability to respond to shifting dynamics. Apply a cross-check between your proposed contractual framework and the actual market for control of your company, strike the right balance and don't be afraid of a little resistance and sometimes a lot of posturing from your party pal.

2
RESPOND, DON'T JUST DEFEND

The concept of takeover 'defence' is outdated. Instead, focus on extracting the best value or outcome for shareholders and mitigating downside risks. The target company's best interests (which typically equates to those of its shareholders as a whole) are the North Star for every director decision. There is always a price at which control will pass. So the response objective ought be extracting compelling compensation for ceding control, securing it for your shareholders, and protecting them from some downside risk along the way.

Of course, an interloper may well have no basis for presenting a compelling counter proposal, or there may be no other merit in its disruption of the existing proposal. That's for the target and its advisers to interrogate; objectively and without fear or favour to the incumbent. Where a private capital interloper is concerned, the analysis can be more nuanced; which is where the next rule plays a vital part.

3
KNOW YOUR VALUE PROPOSITION AND POTENTIAL WEAK SPOTS, AND REVISIT ALL THE TIME

Knowing your value, your market, your business and your peers are all essential elements of corporate hygiene. But being able to self-interrogate your business, its value and its potential weak spots, as if you were an interloper, is something else again. This self-awareness allows you to anticipate an interloper's moves and address shareholder concerns proactively.

The alternative is unpleasant - where material, neglected concerns of your major shareholder/s muddy the narrative of an otherwise attractive proposition; which segues nicely into the next rule.

4
KNOW YOUR INVESTORS BETTER THAN ANY INTERLOPER – AND COMMUNICATE, COMMUNICATE, COMMUNICATE

Like value, knowing your key stakeholders and what they think of your company and your relationship is not something to initiate once you're in play. That foundation is something to build and maintain, so that when an approach comes – and if you are successful, it will – you're starting from a strong base of mutual understanding.

Investor relations need to build from that base and shift up a gear when an interloper appears. Communicating in an open and timely manner with key stakeholders, and tailor-ing the communication to their needs, is how a company can transform its response from one that is vulnerable (to the drama of rhetoric and market speculation) to one that is measured, informed and better positioned for broad-based shareholder support from the get go.

Afterall, early momentum is what brings deals to life, and can stymie agitation for agitation's sake.

5

DON'T BE AFRAID OF THE TAKEOVERS PANEL

Interlopers and incumbent bidders commonly make strategic use of the Takeovers Panel in an actual contest for control. Listed company targets should too – as a tool to serve the company's best interests (provided the target has not itself contributed to the alleged unacceptable circumstances – as the Panel is generally reluctant to second-guess a well-advised board).

The Panel is not a forum for seeking to create nuisance or unjustified delay and yes, it's hard being disciplined when other parties appear less inclined to behave. But being prepared to hold control participants to account, in a measured and tactical manner, can provide demonstrable evidence (for key shareholders and other stakeholders alike) that their company is in safe hands with directors, and advisers alike, who hold their best interests paramount.

TOO SHY (TO BID)?

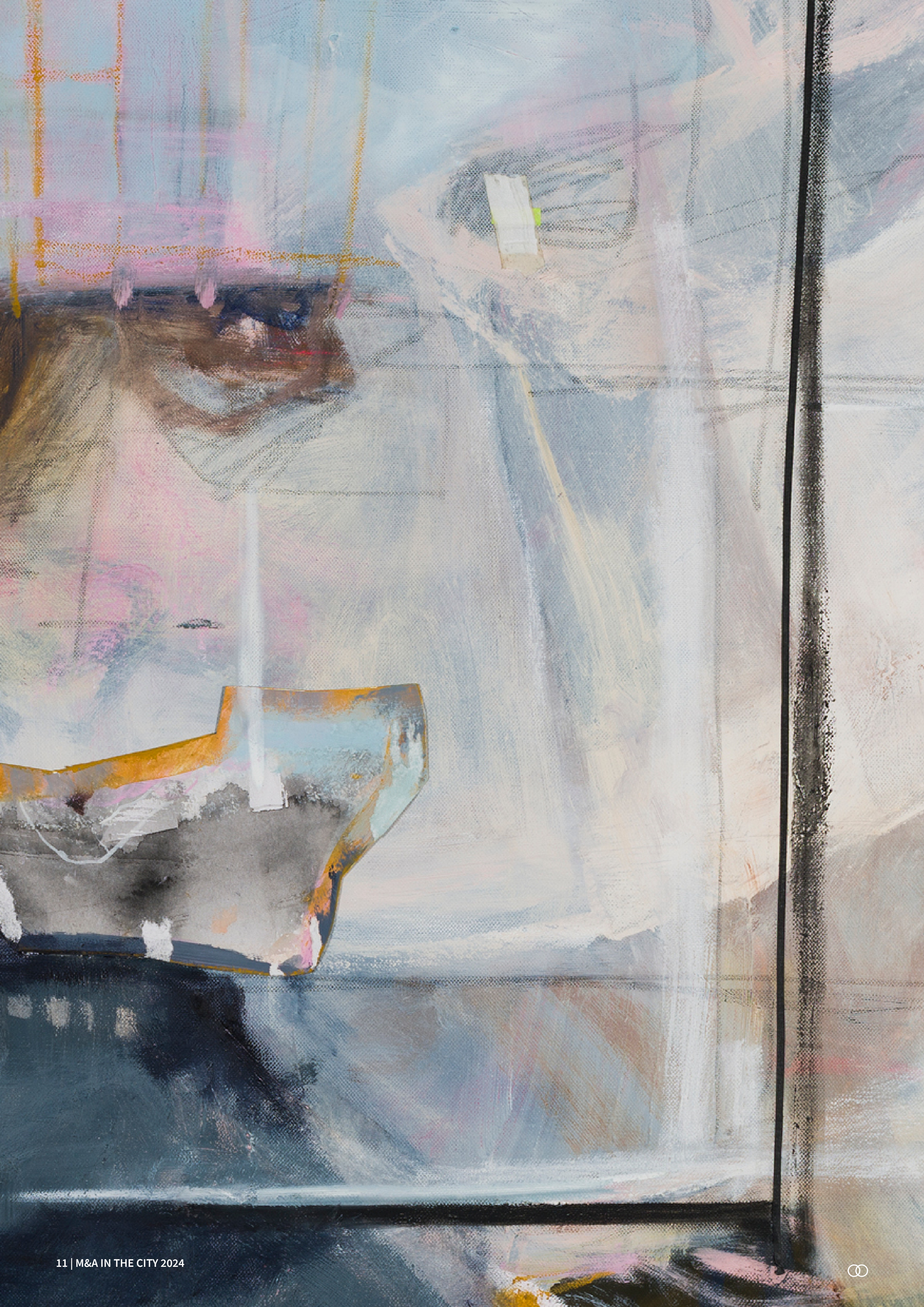
Not everyone wants to be the life of the party, and that's equally the case in a market for control. If encouraged out of their shell, the seemingly shy ones can sometimes surprise you! But how do you deal with a major, potentially blocking shareholder who is too 'shy' to bid themselves, when they are either on the fence or (either quietly or noisily) bringing down the vibes? In cases where a major shareholder is hesitant to bid, consider a dual approach: a scheme of arrangement with a fallback takeover offer. This empowers shareholders to control the outcome and better supports a fair price.

By definition, a *scheme* must always have a minimum acceptance threshold - 50% of shareholders in number present and voting at the scheme meeting, plus at least 75% of the votes cast. Depending on the turnout at the scheme meeting, a major shareholder with ~19% (and even quite a bit less) is going to be able to block the scheme. Contrast a *takeover offer*, for which a sufficiently bold bidder is not required to set a minimum acceptance condition.

Under the parallel approach, the bidder launches a concurrent scheme of arrangement at a particular price, together with a fallback takeover bid (but without a minimum acceptance condition) at a lower offer price. This is intended to encourage shareholders to go with the higher-priced scheme (which, if successful, would guarantee the acquisition of 100% of the target), but if the scheme is defeated or otherwise doesn't proceed, the takeover offer remains 'in reserve' and available to those who are prepared to exit at the lower price – countering that downside risk we mentioned earlier. The lower offer price is justified on the basis that, without a minimum acceptance condition, the takeover mechanism might not deliver control to the bidder.

While a two-pronged proposal can ultimately help unlock a deal (that would otherwise be blocked by an interloper), it can leave a control situation unresolved. That's rarely ideal. And it does take a bit of explaining to shareholders – they aren't invited to two parties, just the one, but will it end in a dance off or an early exit?

The lesson? Dealing with an interloper requires a mindset for strategic engagement and clear communication. The rest is just tactics (and dance moves).



MERGER CLEARANCE REFORMS - WHAT YOU NEED TO KNOW

AUSTRALIAN MERGER CLEARANCE REFORM

- **Existing informal process and merger authorisation regime to be replaced by new mandatory and suspensory clearance regime** with significant changes including to the legal test and appeal process
- Proposed by the Government **to commence January 2026**
- **Thresholds for notification yet to be set:** consultation ongoing

IMPACT ON M&A

The reforms will impact deals that don't currently require ACCC clearance – but will also change the landscape for deals that would go to the ACCC in the current regime

Current scenario	Impact of reforms
Deal has no or minimal competition impacts – no ACCC scrutiny under current regime	• ACCC clearance required where deal value/ turnover/ market share thresholds are met, regardless of competition impacts – so more deals will be notified to and require ACCC clearance compared to current situation • More certainty over which deals will require ACCC clearance • More certainty on the timeframe for ACCC clearance for 'straightforward' clearance applications through envisaged fast track process
Deal would likely go to the ACCC under current regime	• ACCC now has power to block mergers without taking Court action • Appeals of ACCC decisions may become common – as Competition Tribunal process cheaper and quicker compared to existing Court process • Potentially greater certainty of timing for ACCC review than current system – but we could still see extended processes for complex matters (see key unknowns)

DETAILS OF REFORMS

The key changes to merger clearance in the proposed new regime include:

CURRENT REGIME

- Voluntary notification
- ACCC decision is 'advisory' – only Federal Court can prohibit a transaction
- Flexible and informal process – no statutory timeframes or information requirements
- Mixed level of transparency – no public record of most mergers considered by ACCC

NEW REGIME

Obligation to get ACCC clearance

Mandatory: deals above specified thresholds cannot complete until ACCC provides clearance

Timing

Fast track: 15 days
Phase 1: 30 days*
Phase 2: +90 days*
Public benefit submission:+50 days*
Tribunal: 60 days
**Reality will be longer for complex cases - see 'key unknowns' below.*

Decision Maker

ACCC has **legal power to prohibit merger** – no longer up to the Federal Court

Legal Test

To block: ACCC must have reasonable belief that **merger is likely to substantially lessen competition** (which will include strengthening/ entrenching market power) and no net public benefits

Fees + Confidentiality

Scaled to complexity and risk.
Indicative range of $50,000-100,000
No confidential process once notification made to ACCC:
all mergers put on ACCC register

Appeal

Limited merits review to Australian Competition Tribunal

NEXT STEPS

Apr 2024
Gov. announced proposed reforms

Jun - Jul 2024
Consultation on draft legislation expected

Jul – Oct 2024
Consultation on draft regulations expected

Oct 2024 – Apr 2025
Consultation on ACCC guidelines

Jan 2026
New regime starts

KEY UNKNOWNS

- Interaction with FIRB
- Notification Thresholds
- Transitional arrangements (deals signed in the lead up to January 2026)
- Circumstances in which ACCC can 'stop and start the clock' for the timeframes
- Timing for public takeovers
- Application to minority interests and joint ventures

If you would like to discuss any aspect of the merger reform and what this means for your business - Please reach out to our author Christopher Kok, or another of our competition partners.

BIG MACS AND SUPERSIZED REVERSE BREAK FEES

Deal certainty post covid

Keen readers of M&A in the City will know we've observed targets increasingly flexing their muscle on deal protections. We've written about this in the **pre-deal phase**. However, fresh analysis of Scheme Implementation Deeds ("**SIDs**") reveals a similar trend once a deal has been struck. Targets are particularly focussed on ensuring that bidders are held to their bargain and have only very limited abilities to pull out of public M&A deals.

WE THINK THERE ARE A COUPLE OF REASONS FOR THIS

1 **COVID symptoms linger**

The COVID pandemic (and associated volatility in global M&A markets since) has forced bidders and targets alike to stress test their SIDs, and carefully consider the triggers and consequences which apply if a bidder attempts to walk.

2 **Cold-feet frustration**

We've seen a number of high-profile deals where bidders have gotten cold feet after signing a deal. Elon Musk's failed attempt to abort his acquisition of Twitter is an obvious example. There was also the Pendal / Perpetual transaction, where Perpetual attempted to argue (unsuccessfully) that its reverse break fee acted like an option fee – i.e. it could simply pay it and walk if it found a better deal, despite not having an express right in the SID to do so. The court in that instance ultimately disagreed, but the effect of that decision has been to shine a spotlight on how reverse break fees, MACs and other deal protection mechanisms are drafted in SIDs.

So how have we seen targets' focus on deal certainty manifest itself?

THERE ARE 2 KEY TRENDS

- **Big MACs:** The first is what we're calling "Big MACs". Since Covid, we've observed a general increase in the quantitative net asset thresholds which are required to trigger a material adverse change ("**MAC**") condition precedent. These essentially make it more difficult for a bidder to rely on a MAC event to walk from a deal.
- **Reverse Break Fees:** The second trend is in relation to reverse break fees (RBFs). Reverse break fees are becoming increasingly common in the Australian market and have typically hovered at around 1% of equity value (consistent with target break fees). However, since Pendal we've started to see a trend particularly in ultra-high value deals in the Australian market for "supersized" reverse break fees being accepted.

BIG MACS

Bidders will typically insist on a MAC condition precedent or termination right in SIDs, which is typically triggered if an event occurs which significantly and detrimentally impacts the target company.

MACs can be quantitative (ie triggered by an event which has a dollar impact on balance sheet and/or revenue/earnings items) or qualitative (ie defined by reference to a material impact on the target). Our focus here was on quantitative MACs.

We conducted an analysis of 111 SIDs/takeover documents between 2017 – 2024, representing large deals over $500 million in the pre and post covid eras.

Based on our data set, we found that:

For deals with net asset MAC triggers:

- In 2017 -2019 (the pre-covid years), the average MAC net assets threshold, relative to the target's last reported net assets, was **10.5%**
- In 2020 – 2021 (covid years), this average increased to **14.3%**
- In 2022- 2024 (post covid), the average has remained at approximately **15.3%**

For deals with earnings MAC triggers (ie EBITDA/revenue other income measures), we have observed a general uptick post covid, albeit the statistics are more volatile across the data set.

- In 2017- 2019, the average was **14.3%**
- In 2020- 2021, the average was **14.13%**
- In 2022- 2024, the average was **18.7%**

We think the above shows that target boards have become more concerned with MACs during COVID and have generally required higher thresholds but that since COVID there has been no reversion to the mean.

SUPERSIZED REVERSE BREAK FEES

A reverse break fee is essentially a fee paid by the bidder if the deal does not proceed in certain scenarios, for example where there has been a material breach by the bidder, failure by the bidder to obtain a regulatory approval. The ostensible intention is to compensate the target for time and resources spend on a deal which does not proceed. They are also great tools for increasing deal certainty by incentivising the bidder to comply with its obligations.

Importantly, whilst reverse break fees aren't new, we have seen an increase in their use over the last few years (particularly where a target break fee has been negotiated).

Interestingly, our data set also reveals an increase in the quantum of reverse break fees - something we predicted after the Pendal decision.

Historically, reverse break fees have typically hovered at 1% of equity value in line with break fees payable by the target (consistent with Panel guidance). While reverse break fees aren't subject to Panel guidance, we've often seen similar sized fees being negotiated in the interests of reciprocity.

Since Pendal, a key trend which we've observed in recent transactions has been larger or "supersized" reverse break fees in a number of high value transactions, namely:

- Newcrest/ Newmont – which had an RBF at 2.01% of equity value;
- Altium /Renesas – which had an RBF of 4.55% of equity value;
- Alumina/Alcoa – which had a 2.27% reverse break fee; and
- Boart Longyear (Target)/ AB Acquisition Corporation US – 3.85% of deal value

REVERSE BREAK FEES – MORE AND BIGGER

- 64.3% of deals over $500 million included a reverse break fee in 2023, remaining fairly consistent with prior year (60% in 2022).
- In 2023, the majority of deals that had target break fees also had RBFs - about 81.8% (or 9 out of 11.
- This compares with 36.4% of deals in 2019, and 41.7% in 2020.

CRAVING CERTAINTY

What's driving this trend? We think it comes down to targets' desire for deal certainty.

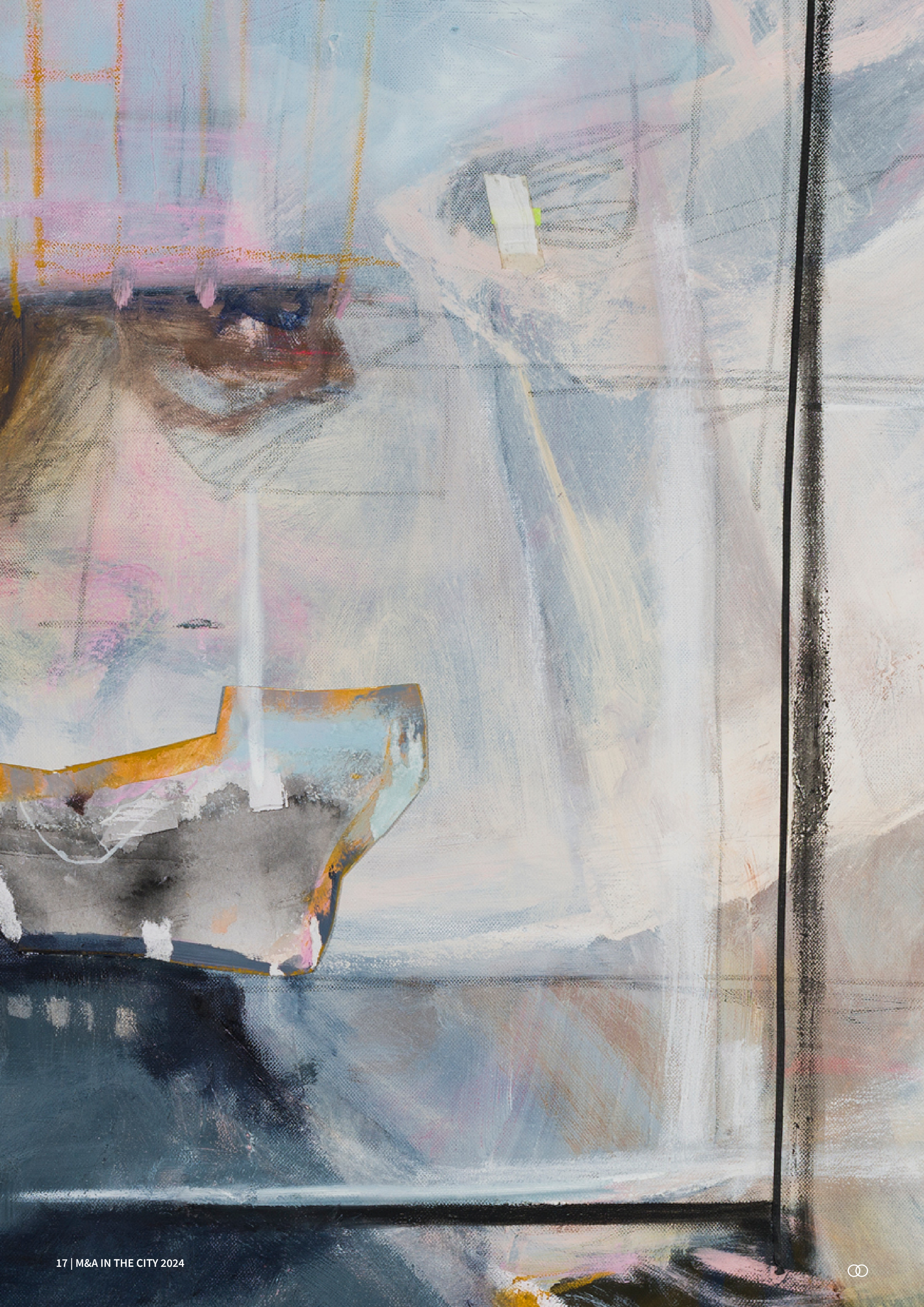
Looking at this from first principles, the different in size between a break fee and a reverse break fee is often justified because the impact of a failed deal on the target is generally much worse than for the bidder, as the target's business has been disrupted by the control transaction, potentially for many months. A 1% reverse break fee can at times, leave the target in particularly vulnerable position.

From a target's perspective, higher reverse break fees can also serve as a meaningful "stick" to deter bidders from breaching their obligations. Pendal showed us that if a bidder attempts to walk from a deal in breach of its obligations (for example, to pursue alternate transactions), it will usually be open to the target to seek an order of specific performance to compel them to complete (a point the court in Pendal made clear). However, these orders are ultimately at the discretion of the court, and in practice may be difficult to obtain, particularly if the deal is in its early stages or there are significant conditions outstanding. By contrast, enforcing payment of a reverse break fee will usually be a much easier remedy for the target to obtain.

Finally, a higher RBF may be justified where a target does accept it effectively as an option fee – eg. where the bidder has negotiated a termination right which allows it to walk if it receives a superior control proposal for itself, which the bidder board wishes to pursue instead in order to satisfy its fiduciary obligations.

THE FUTURE

In summary, in our view both COVID and Pendal reshaped target's desires to prioritise deal certainty in ways we had not anticipated previously. This has led to both Big MACS and supersized break fees becoming increasingly common in high value M&A transactions in this market. For reverse break fees, this has primarily been in the ultra high value end of the market. But we expect to see this become more prevalent in the years ahead.



THE VIEW FROM NEW YORK

KWM Public M&A Partner Nicola Charlston and private capital / M&A Partner Anthony Boogert recently returned from International Bar Association's annual M&A conference in New York, discussing everything from global M&A trends, outlook, hot topics, Private Equity, governance and activism, healthcare and life sciences, geopolitics and competition policy and plenty more.

Below is a lightly-edited transcript of their podcast discussion of what they learned.

ANTHONY BOOGERT

Nicola what were the top takeaways for you?

NICOLA CHARLSTON

Focusing on the good news, it seemed to be that the consensus view is that M&A activity is likely to continue it's rebound from the relative low of last year, with strategic M&A players in particular leading that charge. The message we got from our meetings and from the conference was also that financial sponsors are expected to re-enter the market as debt markets reopen. Valuation gaps are starting to contract. For equity markets and IPOs, not overly positive still, but certainly some observations that equity markets, because valuations are high, that does support M&A by strategic players, especially where they are looking to provide share or scrip consideration and can get access to acquisition financing.

So what we've heard is that there's predictions for a strong first quarter in 2025, FY 2025, for IPOs. It would be great if that translated down to the Australian market as well.

It was interesting to hear the US domestic view on the upcoming election and how that might play into M&A generally or transactional activity, but also to some of those particular sectors like infrastructure and tech.

ANTHONY BOOGERT

Interestingly, we heard that the US election is not expected to have a material impact on M&A and the capital markets activity. Most people we spoke to felt that while the election was creating a lot of noise, it's unlikely to have a major impact on M&A - given the uncertainty was already priced in, and the business community had already experienced both a Biden and a Trump presidency. There's also broad bipartisan support for infrastructure spending, so that area is expected to be strong, regardless of who wins this election. Finally, there seemed to be a consistent view that we're going to see more activity in tech M&A as the regulators' attention on big tech softens.

NICOLA CHARLSTON

Yes, that was really interesting to hear about the upcoming changes in the US merger clearance process and how the information requirements and applications are going to become even more onerous and lengthy. I think a lot of foreign lawyers would think that they're already relatively onerous and lengthy as they are. And of course, we're also gearing up here in Australia for changes in our merger clearance laws.

ANTHONY BOOGERT

One interesting presentation came from Anu Aiyengar, global head of M&A JP Morgan. She talked about the three Ds. Do you want to run through them?

Listen here on

Spotify

NICOLA CHARLSTON

A really interesting presentation from Anu, definitely one of the highlights of the conference. What she was talking about in terms of the three Ds were: deglobalization, decarbonization and digitization.

Deglobalization, she was highlighting this trend around on or near shoring to protect supply chains and infrastructure investment, also noting that infrastructure is one of the fastest growing private asset classes, and this seemed to be particularly relevant in the US, where infrastructure is aging and the investment need into physical infrastructure is critical for the US. Second D, decarbonization, she had an interesting statistic that global investment in energy transition grew around three times, just from 2019 to 2023, to US $1.8 trillion, and a stat that 50% of global investors aim to invest in climate solutions to reduce portfolio emissions. The other interesting point I thought on decarbonisation was energy transition expected to be 70% to 80% privately funded, but an observation that government's contribution will be critical, as well as both a financial and policy catalyst for that investment. And then the Third D, digitization, and of course, AI in particular.

ANTHONY BOOGERT

Wow - We've been talking about how long we haven't mentioned AI yet!?

NICOLA CHARLSTON

Well, it's clearly not an earnings call, because one of the other interesting statistics from a news presentation was from a Stanford University report that looked at earnings calls in 2023. It found that 2796 mentions were made of AI in 2023 earnings calls, which was backed up by 81 point 6 billion USD in investment. And that's just in the US so AI, huge focus.

Interesting way that she described it as a technology infrastructure and an energy challenge

ANTHONY BOOGERT

Interesting that the climate side of that is just, you know, becoming increasingly important, not just the digitization.

Okay Nicola, final question: What does everything we've heard mean for our M&A markets?

NICOLA CHARLSTON

Well, it might be overly optimistic, but I am definitely hopeful, based on what we heard in the last week, that some of those factors we've touched on around opening of debt markets, the contraction of the valuation gap, means that M&A activity will continue to trend upwards over the second half of this calendar year, hopefully those buyer and seller price expectations continue to converge, which seems to have stifled quite a lot of M&A activity in this market, at least with some failed deals or deals on the go slow and if not maybe some creative deal structuring can overcome any of those gaps.

One area that we did hear about over and over was the ongoing and increasing complexity of the regulatory landscape. We're hoping that that doesn't unduly impede transactions that would otherwise make sense, because it's certainly top of mind for a lot of the deal doers that we spoke to.

What about you, Anthony, what were your key takeaways?

ANTHONY BOOGERT

On equity markets, they continue to be puzzling. The IPO market still appears to be shut globally, which was interesting - it's not just an Australian problem. Although, there does seem to be a consensus that there'll be a strong Q1 in 2025, with the preparatory work commencing now. As you mentioned earlier, equity markets continue to be high and this is supporting M&A by strategics - using share consideration for acquisition.

It sounds like we're going to see a rebound in tech M&A as some of the regulatory scrutiny starts to ease and the valuation gap contracts. Health care continues to be challenged, though, with cost pressures continuing to be a global problem.

NICOLA CHARLSTON

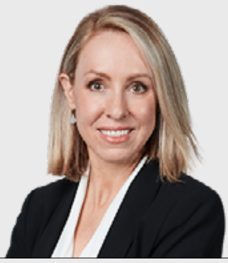
Yes that sector still has some issues facing it - but still one of the most active sectors, in JP Morgans presentation it was flagged as healthcare and life sciences as the third most active sector globally from an M&A perspective over the last 12 months.

All very interesting. A few things to ponder there for anyone interested in transactional activity and M&A. Thank you, Anthony, you're a great travel partner as always.

ANTHONY BOOGERT

Thank you, Nicola likewise.

THE M&A IN THE CITY TEAM



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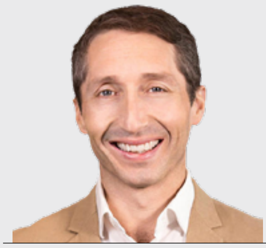

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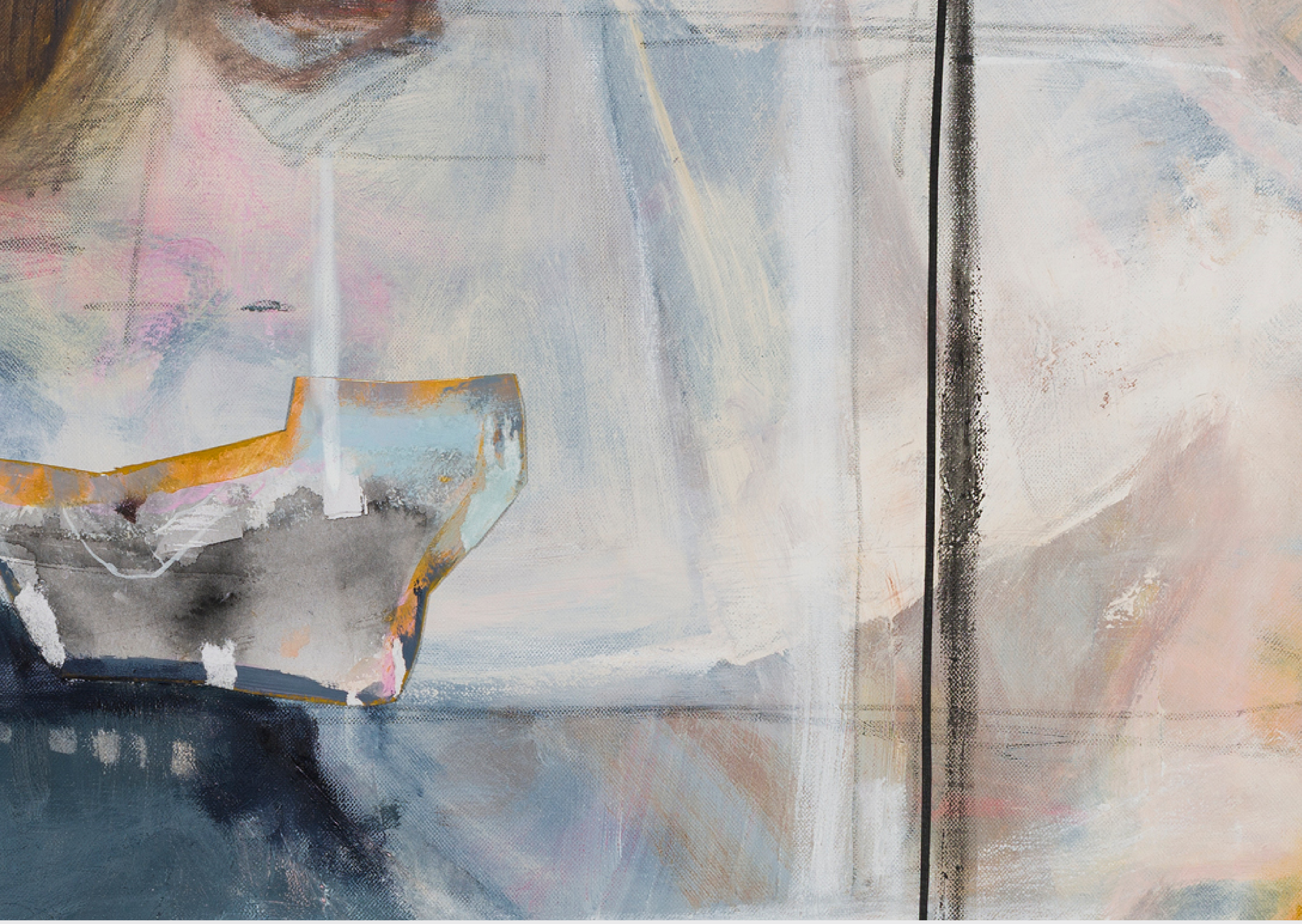

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