KING&WOOD MALLESONS
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M&A IN THE CITY

2024

Port by Jane Hoggard

WELCOME TO M&A IN THE CITY FOR NOVEMBER 2024

As markets digest the outcome of America's election, we take you on a journey through the shifting landscape of M&A.

Stepping back from the sometimes excitable narrative around 'shrinking' public markets, **We'd like to see you in public** turns to the numbers to uncover the full story behind the rise and rise in private dealmaking. Some numbers are striking, others surprising. With the full picture in focus, we ask what can be done to ensure public markets continue to be a thriving part of our financial ecosystem – a vibrant, transparent and fertile field for founders, dealmakers and investors to sow capital, take risks, and grow wealth.

In **Ticked off about supersized reverse break fees?** We get technical on one of the most fascinating tactical talking points in modern dealmaking – break fees and other completion incentives. We ask just how significant some eyewatering fees actually are and how effectively they generate the certainty they're designed to achieve. Exploring alternatives, we talk through ticking fees as another way of ensuring everyone party to a transaction has their eyes on the prize of getting the deal done. Perhaps we could torture the 'drive for show putt for dough' golfing analogy - *draft for show, sign for dough?* OK – back to the drawing, err drafting board.

Industry leaders may be optimistically anticipating a resurgence in deal activity as macroeconomic conditions begin to stabilize, fuelled by a growing sense of urgency among dealmakers to act on assets acquired at pre-pandemic valuations. However regulatory risk continues to loom in dealmaking considerations. We bring you the latest on **Australia's Merger Clearance reforms – Impacts for M&A** – examining how upcoming reforms to the merger clearance regime will impact dealmakers. Walking through the additional detail on new ACCC requirements highlights the need for strategic timing and careful planning.

We spotlight a nation known for its attention to detail in **Japanese involvement in large M&A transactions: Will the trend continue?** The article is an insightful explainer of the factors behind Japan's increasingly active outbound dealmaking wave, as well as what is driving greater receptiveness to international bids in its own markets. There's even a complimentary podcast dispatch on the latest from Tokyo (and a drink recommendation you can't miss).

And to wrap up, our **Public M&A market on a page** gives you an easy overview of the state of public markets' dealmaking in the final stretch of 2024.

As always, we hope you find the contents interesting and insightful.

MEET THE EDITORS

NICOLA CHARLSTON
PARTNER

DANIEL NATALE
PARTNER

WILL HEATH
PARTNER

ANTONELLA PACITTI
PARTNER

DAVID FRIEDLANDER
CHAIR

IN THIS EDITION

TICKED OFF ABOUT SUPERSIZED REVERSE BREAK FEES?

"Target secures reverse break fee worth hundreds of millions!"

Headlines like this grab attention and are often heralded by target boards and their advisers as a triumph in securing deal certainty, or at least an indicator of negotiating prowess over the bidder (and their adviser counterparts!). In this edition of M&A in the City, we peel the lid on 'supersized' reverse break fees and take a proper look at whether they deliver the deal certainty sought by targets.

In our previous edition of M&A in the City, we explored a recent trend in bigger reverse break fees – in particular, we looked at a number of high value, Australian transactions where "supersized" reverse break fees had been negotiated.[1]

Supersized reverse break fees are not a new phenomenon. They have been a feature of Australian deals for a while[2] and have on occasion exceeded more than 10% of the target equity value.[3] While less common in Australia, supersized reverse break fees are commonplace in North American markets where they are generally in the range of 4% - 6%, although conditionality and complexity can push them even higher. In cross-border transactions, overseas bidders are often pleasantly surprised to learn that the quantum of reverse break fees in Australian deals is (in the interests of reciprocity) regularly the same amount as the target break fee – i.e. capped at 1% of target equity value to track Takeovers Panel guidance.

With the Takeovers Panel's apparent endorsement of supersized reverse break fees in *Westgold Resources Limited*,[4] we investigate whether supersized reverse break fees are the be-all and end-all for target boards and their shareholders (and should be a key negotiating point in the boardroom), or whether there's a better approach to keeping an agreed deal on track.

WHY NEGOTIATE A SUPERSIZED REVERSE BREAK FEE?

As we've previously explored, supersized reverse break fees are seen as helping targets secure deal certainty – in that, the magnitude of the reverse break fee holds the bidder's feet to the fire – whether it's in satisfying regulatory approval conditions or otherwise performing its obligations under the implementation agreement. We've explained that supersized reverse break fees can be justified in the sense that, having been "marched up the hill" by the bidder, it is the target who will bear costs that far exceed those of the bidder – given the disproportionate impact of the bidder's offer on the target's business (whether this is indeed the case will of course depend on the particular transaction).

But surely size isn't everything? And does it really assuage target shareholders' disappointment – they've still lost the deal.

Perhaps it is time to step back and reflect: is the energy and time spent negotiating the quantum of a supersized reverse break always worth it? Could that effort be deployed in other ways that better deliver the fundamental objectives of deal certainty and value to target shareholders?

1. We consider a reverse break fee to be "supersized" if the quantum of the fee exceeds 1% of the equity value of the target.
2. For example, the Recall Holdings / Iron Mountain Inc. A$2.6 billion scheme in 2015 included a reverse break fee of A$76.5 million (in respect of antitrust regulatory approvals), representing 3% of deal value and over 3.3% of target equity value.
3. For example, the Sirtex Medical / CDH Genetech and China Grand Pharmaceutical A$1.9 billion scheme in 2018 included a reverse break fee of A$200 million, representing 10.5% of deal value and more than 10% of target equity value (on signing the implementation agreement).
4. [2024] ATP 15. For completeness, we note that the Panel did not reach a concluded view on whether the 'Termination Fee' should be properly characterised as a 'reverse break fee'.

WHEN IS A SUPERSIZED REVERSE BREAK FEE JUST FOR SHOW?

It's important to remember that reverse break fees are only negotiated in the context of an agreed deal – where the target board has determined it is in the best interest of its shareholders to pursue the deal.

At this stage of a transaction, the target's focus should be on securing the transaction – that is, reaching implementation - and ensuring the consideration offered is ultimately delivered to target shareholders. With this objective in mind, the financial 'stick' of a large reverse break fee is intended as a device to increase, or at least maintain, deal certainty: by making a bidder think twice before triggering a payment obligation (for example, by breaching the implementation agreement).

But do supersized reverse break fees (cf. 'standard' reverse break fees) actually have this deterrent impact on bidders, especially those with a broad base of their own shareholders, or are there better ways to promote the same thing?

In many cases, the quantum of a supersized reverse break fee - while eye-watering - may simply reflect the differing sizes of the target and bidder. While the reverse break fees in each of the below deals were 'supersized' (i.e. being more than 1% of the target equity value), it was either equal to or less than 1% of the bidder equity value.

Deal	Break Fee (BF)	BF Target Equity Value (~%)	Reverse Break Fee (RBF)	RBF Target Equity Value (~%)	RBF Bidder Equity Value (~%)	RBF Multiple Of BF (Quantum)
Newcrest / Newmont*	US$174 million	1.0%	US$374.7 million[5]	2.01%	1.0%	2.15x
Altium* / Renesas	A$91.3 million	1.0%	A$410.8 million	4.55%	0.9%	4.49x
Alumina* / Alcoa	US$22 million	0.6%	US$50 million	1.3%	0.9%	2.27x

KWM acted for Newmont, Altium and Alumina

In cases where the agreed break fee and reverse break fee are proportional to the target and bidder's respective equity values (say, 1% respectively), it is questionable whether the reverse break fee actually provides the bidder with any additional motivation to comply with the implementation agreement and to 'get the deal done' than the corresponding break fee imposes on the target. Of course, if we weren't talking 'mega deals', the proportionality vs motivation argument could be more nuanced (and potentially harder to sustain).

'Back in the day', break fees *per se* were considered inconsistent with doing deals 'the Australian way', regardless of their quantum; and their introduction to our market was borne out of a desire to promote competitive tension in contested transactions, especially those with a cross-border element (rather than impose a potentially coercive obligation on a target and its shareholders). Our pals in the UK have taken the other path, effectively outlawing break fees and all manner of exclusivity/deal protection fun.

Generally, a reverse break fee is triggered by a circumstance within the control of the bidder – for example, if the bidder ceases to support the transaction or otherwise commits a material breach of the implementation agreement. It makes sense that the stronger your commitment, the more likely you are to agree to a large reverse break fee: assuming the triggers are tied exclusively to your own commitment and ability to control them – particularly if you can extract meaningful concessions from the target in return.

Where a reverse break fee is triggered by a circumstance beyond the control of the bidder, the bidder will generally seek to agree a lower amount payable for those events to justify the trigger. In the Newcrest / Newmont transaction, the reverse break fee payable for a failure to obtain Newmont stockholder approval was not 'supersized' – it was limited to third-party costs and expenses actually incurred by Newcrest – being a trigger not entirely within bidder's control but suitably differentiated from the normal deal risk here in Australia, where bidder shareholders are rarely required to approve a deal (thanks ASX Listing Rules!). There was no reverse break fee (let alone a 'supersized' reverse break fee) payable if Newmont failed to secure any other regulatory approvals (other than where the failure was linked to a material breach by Newmont).

5. The reverse break fee trigger in the Newcrest / Newmont transaction that Newmont obtain Newmont stockholder approval for the transaction was limited to third-party costs and expenses incurred by Newcrest.

And this real-life example brings us to one of the (relatively) unspoken things about supersized break fees: are they actually enforceable, or is it more about the show? Like all break fees, a reverse break fee ought to align with genuine reimbursement of costs (in this case, the target's). If it is out of all proportion to the target's legitimate commercial interests in the bidder performing the scheme, such that it is unconscionable for the target to enforce the reverse break fee (which super-dooper sized reverse break fees could be), it could very well amount to a penalty and be unenforceable to the extent it is not compensatory. Also, there must come a point where a supersized reverse break fee is so large that its effect is anti-competitive or operates as a poison-pill / unacceptable lock-up device in respect of the bidder. Unlike in the US and even the UK, there is no direct judicial authority to guide the application of the penalties doctrine in public M&A deals Down Under. And we all tend to focus on the Takeovers Panel's guidance – which is limited when it comes to a break fee in reverse – in deal negotiations.

BUT REGULATORS ARE MAKING DEALS SO MUCH LESS CERTAIN!?

As the old adage goes: "time kills deals". It's fair to say that the threat of paying a supersized reverse break fee might motivate an otherwise recalcitrant bidder to deploy additional focus and resources on securing prompt regulatory approvals, or push an increased willingness to agree to a regulator's conditions. And with the general uncertainty that the pandemic brought with it, it's fair to say that reverse break fees grew in prominence, and have continued to do so.

An implementation agreement will generally include obligations on the bidder to do all things necessary to obtain relevant regulatory approvals, and may prescribe a timetable for relevant filings to be made. Alas, once a filing has been made, there is of course little that a bidder can actually do to meaningfully expedite a regulator's consideration of the deal – and a supersized break fee may make little practical difference to the outcome.

Turning back to the context of an agreed deal, and especially one involving bidder scrip consideration, isn't the onus on both the target and the bidder to cooperate in obtaining the necessary approvals as a vital step in expeditiously delivering the transaction to their respective stakeholders? And in ensuring that the combined group that ultimately results from the deal is optimised, both in remaining 'in tact' and appropriately positioned for ongoing regulatory compliance. The prospect of being paid a significant lump sum seems like a distant consolation prize for failing to deliver a transaction the target has committed to championing and securing for its shareholders – and questions could be asked of the target board as to the concessions given in extracting that supersized amount.

ARE TICKING FEES THE ANSWER?

While reverse break fees are an established feature of Australian public market deals and are here to stay (in a supersized form or otherwise): target boards should be encouraged to explore devices that can be deployed in tandem with a reverse break fee – rather than simply seeking to extract the largest possible fee from the bidder – and ones that directly flow through the shareholders.

Returning to the premise that the target should be motivated to complete an agreed deal, one approach is the use of ticking fees.[6]

Ticking fees are traditionally delivered directly to target shareholders in the form of an uplift to the consideration payable, and compensate shareholders for deal delay (for example, due to regulatory approvals taking time to obtain). Generally, a ticking fee is additional consideration per share that accumulates per day (beyond a certain prescribed period) – in the context of scrip consideration it may take the form of a permitted dividend paid by the target to its shareholders on completion of certain deal milestones (requiring the target board to determine whether the payment of a permitted dividend, from the company's funds, is appropriate in all the circumstances).[7] Although less common to date, the fee could be provided in the form of scrip via an increase to the scrip exchange ratio.

We see a number of benefits to ticking fees, including that they:

- reinforce the parties' commitment to the transaction (for example, the ticking fee is generally payable on completion – the target is not put in a potential conflict position of deciding whether to terminate and be paid a reverse break fee or whether to continue to pursue the deal) and the magnitude of the ticking fee is generally insufficient to motivate a target to deliberately 'go slow' in doing its bit;
- are delivered directly to target shareholders (i.e. target shareholders receive the additional consideration, whereas a reverse break fee is paid to the target); and
- are generally proportionate to the loss or additional, genuine cost incurred by the delay (for example, they effectively provide interest to target shareholders as compensation) and there should be little risk of a ticking fee being an unenforceable penalty or anti-competitive.

It may be advisable for a target board to seek to extract a supersized reverse break fee in conjunction with a ticking fee, so we're definitely not suggesting the two are mutually exclusive.[8]

Target boards and their advisers should negotiate an appropriate package of devices to increase deal certainty, deliver meaningful value to shareholders and mitigate potential delays – and bidders should carefully consider the kind of devices they agree to, with a broader perspective on what will motivate both parties and legitimately compensate the target and its shareholders for delay. It is not simply the case that 'bigger is always better' – for example, a target (and its shareholders) may benefit from extracting a smaller reverse break fee in conjunction with an appropriate ticking fee – provided the target is prepared to forego the flashy headline in the interests of deal certainty!

6. For recent examples of agreed ticking fees in Australian public market transactions, see: CSR Limited / Compagnie de Saint-Gobain (2024), Pacific Smiles / National Dental Care (2024), Origin Energy / Brookfield (2023) and Alliance Aviation Services / Qantas (2022).
7. For example, the Alliance Aviation Services / Qantas deal.
8. See CSR Limited / Compagnie de Saint-Gobain for an example of a combination of a reverse break fee and ticking fee.

AUSTRALIAN MERGER CLEARANCE REFORMS | IMPACTS FOR M&A

WHAT'S HAPPENING?

- Existing informal process and merger authorisation regime to be replaced by a new mandatory and suspensory merger clearance regime
- Proposed by the Government to commence January 2026 but deals in 2025 will be impacted
- Reforms will require parties to give strategic consideration to the timing of upcoming deals and the transition arrangements
- Reforms likely to result in more deals requiring Australian Competition and Consumer Commission (ACCC) clearance and the ACCC having a broader scope to oppose deals

WHAT MORE DO WE KNOW NOW?

The Government has introduced into Parliament the Bill for the new merger control regime. It sets out the legal framework for the new regime, including what types of transactions cannot proceed without ACCC clearance, the timeframes for the ACCC's review and the appeal rights from any ACCC decision. The Senate has referred the provisions of the Bill to the Senate Economics Legislation Committee for inquiry and report by 13 November 2024.

The proposed notification thresholds have also been released. Consultation in relation to the thresholds and key details that will determine how they apply is ongoing.

WHAT'S GOING TO BE THE IMPACT ON M&A?

1. **More deals subject to ACCC clearance:**

   The notification thresholds are likely to capture deals that would not typically be notified to the ACCC under the existing regimes, including acquisitions by large corporations or funds that have no competitive effects or overlaps, and some land and patent acquisitions.

2. **More timing certainty for some deals:**

   Statutory timeframes will provide greater timing certainty for transactions that do not raise any competition issues (e.g. a 15 business-day fast track approval process) but more complicated reviews are still likely to take many months (e.g. a 90 business-day timeframe but with scope for significant delays).

3. **Broader powers for ACCC to block deals but quicker appeal route:**

   The ACCC will be given a broader scope to block deals (due to changes to the legal threshold) and the appeal rights for a decision by the ACCC to block a merger will be more limited than what is currently available for ACCC decisions in the informal merger clearance process. However, appeals of ACCC decisions may become more common, as the appeal process will be substantially quicker and cheaper.

4. **The transition arrangements will impact deals in 2025:**

   Parties should carefully consider transaction timelines to avoid delay or risk during the transaction period (e.g. having to restart a review under the new regime).

DOES MY DEAL NEED ACCC CLEARANCE?

1

Is it an acquisition of either:

- a controlling interest of shares, unit trusts, or managed investment scheme; or
- the **assets** of a person or corporation?

+

Control

- **Aligned to s50AA definition in Corps Act** (capacity to determine the financial standing and operating policies of a body corporate)
- **'Bright line' test** requiring notification of all acquisitions of more than 20% shares in private/unlisted companies where one merger party has more than $200 million turnover
- **Safe harbour** for acquisitions of < 20% voting power in listed companies/schemes or unlisted companies with > 50 members

2

Does it fall within one of the notification thresholds?

1 'Economy wide' monetary threshold	Combined Australian turnover of merger parties (including acquirer group) is at least **$200 million** AND • EITHER the Australian turnover is at least $50 million for each of at least two of the merger parties OR the global transaction value is at least **$250 million** • Target has material connection to Australia (i.e. carrying on or intending to carry on a business in Australia)		**Turnover/ Acquirer group** • Definitions of 'turnover' and 'acquirer group' to be included in regulations (which are yet to be released).
2 'Very large acquirer' threshold	• Acquirer group Australian turnover is at least **$500 million** AND • The Australian turnover is at least **$10 million** for each of at least two of the merger parties		
3 3 year cumulative turnover threshold	• Combined Australian turnover of merger parties (including acquirer group) is at least **$200 million** AND • The cumulative Australian turnover from acquisitions in the same or substitutable goods or services over a 3 year period is at least **$50 million** AND • Target has greater than **$2 million** in Australian turnover OR	• Combined Australian turnover of merger parties (including acquirer group) is at least **$500 million** AND • The cumulative Australian turnover from acquisitions in the same or substitutable goods or services over a 3 year period is at least **$10 million** AND • Target has greater than **$2 million** in Australian turnover	**3 year look back** • Practically, it's unclear at what point in time the turnover of the assets/businesses previously acquired should be assessed - the date of the previous acquisition or the current date (at which point the turnover would presumably be consolidated with the acquirer group's other business and therefore double-counted)
4 Targeted thresholds	• Set by Ministerial instrument • The Government has said it will use this power to mandate that every merger in supermarket sector will be notified • Considering whether to also target deals in sectors such as fuel, liquor and oncology radiology		

NEXT STEPS

- **10 October 2024** Legislation introduced into Parliament
- **Q4 2024 – Q1 2025** Consultation on review timelines, fees & guidelines
- **30 Jun 2025** Last day to lodge merger authorisation application
- **1 July 2025** Parties can voluntarily notify under the new regime
- **1 Jan 2026** New regime of mandatory notification commences

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.

WE'D LIKE TO SEE YOU IN PUBLIC

The numbers behind the narrative on private markets' rise

In the post-COVID period, a large number of ASX-listed companies have been acquired and delisted, while IPO markets have run quiet. We read regular and frequent reports of ASX 'shrinking',[9] but what does this really mean, and what can be done?

We dig into the data and share some ideas for potential policy changes to strengthen public markets' attractiveness for companies and investors.

First, we need to get the facts right. As we describe further below, ASX provides publicly available and transparent statistics on a range of data points. These include the total end of month market capitalisation of ASX and the number of listed entities. For example, on the basis of aggregate market capitalisation to end September 2024, ASX has grown since the post-COVID period. However, on the basis of the total number of domestic and foreign equity issuers (including entities comprising a stapled group), ASX could be said to be 'shrinking'.[10]

This puts into sharp focus the health of the IPO market, which is currently at its weakest in 15 years as companies appear to choose to stay in (or transition into) private markets over listing on the ASX. What then is driving the trend to stay (or go) private and what might be done to make public markets more attractive?

FIRST, WHERE IS THE MONEY GOING? SOME GLOBAL DATA

Figure 1: Far fewer companies are listed on major stock markets than in the past

Number of public companies:

UK data is for the main market of the London Stock Exchange only. Data to December 2022
Source: London Stock Exchange, Refinitiv Datastream, Scheoders, World Bank Development Indicators, and World Federation of Exchanges.
Source: World Economic Forum, *The global supply of equities is shrinking, 24 April 2024*

9. See the Australian Financial Review reports at 10 April 2024 (here) and 5 June 2023 (here).
10. See ASX data here.

Data from across global markets bear out the notion of public equity markets shrinking overall. Globally, there are reports[11] of a net reduction of $120 billion in public equities in the year to April 2024, compared to a $40 billion decrease in the previous year. The drop in the number of listed companies has been worst in the UK – 75% lower than the 1960s.

The impact of this can be felt in different ways. Public market de-listings reduce what is available for investors of all sizes seeking to diversify risk and exposure, and asset valuations and debt levels are less transparent which is concerning to regulators. General information asymmetry is not only an issue for regulators, but also for investors who may not have access to information of the same quality or timeliness as in public markets.

IN ABSOLUTE TERMS, ASX IS NOT REALLY SHRINKING

Our KWM analysis of ASX data shows the rising collective value of equities listed on ASX has offset the declining number of individual entities. As shown below, this means the 'shrinking' descriptor confuses two separate points – aggregate market capitalisation (which has risen) and number of listed entities (which has incrementally fallen).

Over the last 7 years the number of companies is only down 88, or 3.9% fewer – a smaller decrease than other major global listed markets.

Against this decrease in the number of listed entities, the total market capitalisation has increased 65%, or about 36% adjusted for inflation.

Australia's market capitalisation to GDP ratio is about 100% and that hasn't changed materially in the last 10 years. For comparison, this places Australia in between the USA at 156% and the UK at 70%.

AUSTRALIA – BY THE NUMBERS

A$2.5t
GDP

A$2.6t
ASX MARKET CAP

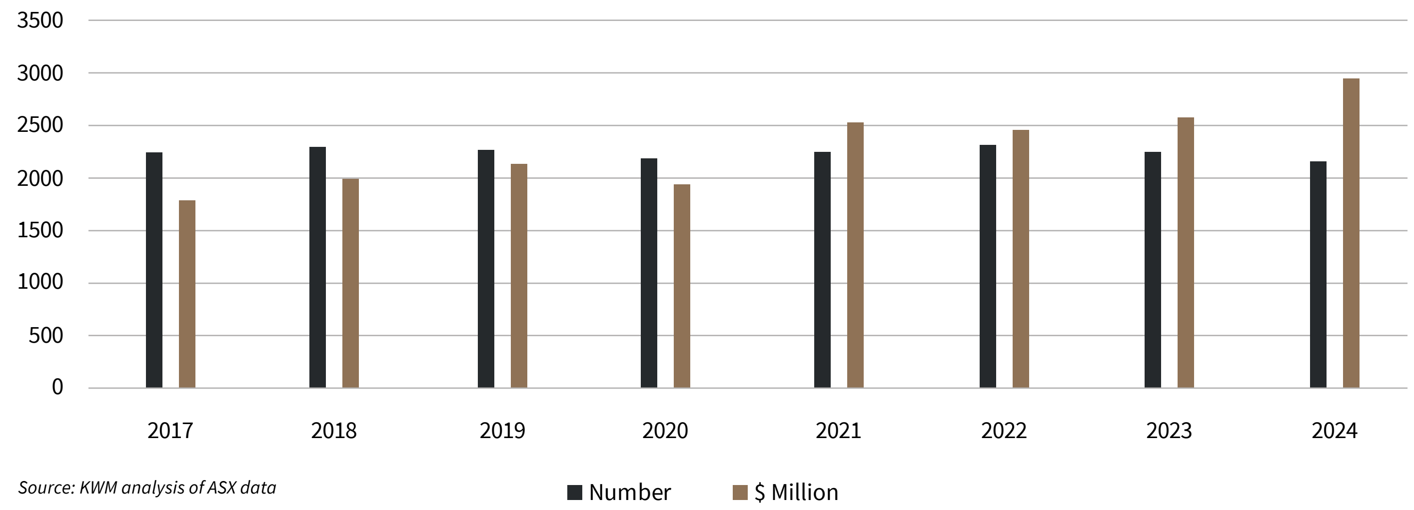
A$3.5t
SUPERANNUATION SECTOR

A$188b
PRIVATE DEBT

A$66b
PRIVATE EQUITY FUNDS FOCUSING ON AUSTRALIAN COMPANIES

11. JP Morgan quoted in *The global supply of equities is shrinking*, 24 April 2024, World Economic Forum

Number of listed entities and market capitalisation



Source: KWM analysis of ASX data

The numbers may not seem to be moving much, but what is happening to the ASX - and equity markets globally - is a bit like looking in the mirror each day as you age. The change starts out as imperceptible, and one day you realise things are not as they were. The numbers show an ASX that is stable and gradually consolidating, but it is not growing at anything like the apparent rate of the market for private deals. The recent public attention to the issue reflects that acceleration. The biggest deal of 2024, the $24 billion private sale of AirTrunk to Blackstone and CPPIB (on which our KWM M&A team acted), dwarfs the biggest IPO on ASX, Guzman Y Gomez, which raised $335 million.

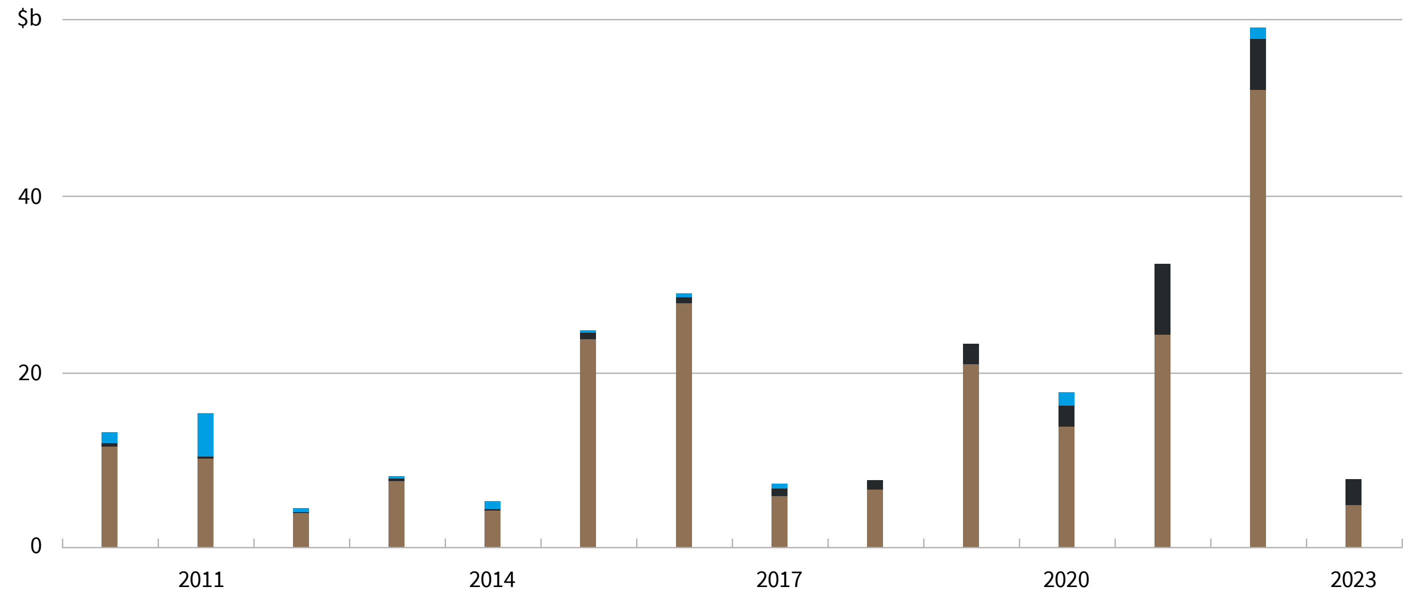
BY CONTRAST... THE GROWTH IN PRIVATE DEALS

Reserve Bank research shows the rising trend and then dramatic post-pandemic spike in Australian private equity deals in 2022. The drop in 2023 is likely a function of the rapid rise in interest rates as central banks globally shifted away from record low interest rate policies in the rush to combat inflation that year.

We expect the figures will be higher for 2024 with the AirTrunk transaction. 21 new take-private deals were reported in Q1 of 2024, and there have been more since. Measured in terms of % of GDP, the UK has seen a doubling in volume of private equity deals similar to Australia, however the US increase has been less dramatic.

A similar shift is happening in debt markets, with global private credit assets under management quadrupling over the past decade to US$2.1 trillion in 2023 (IMF 2024).

Australian private equity deals*
in 2023 dollars



WHAT HAVE BEEN THE DRIVERS?

Much has been written about the forces driving this change: 'ZIRP' (Zero Interest Rate Policies) that provided private and venture capital firms with easy access to cheap capital have undoubtedly played a leading role, amplified by those firms offering terms more attractive to founders weighing public or private strategies. The decrease in supply of public investment opportunities is occurring in parallel with the steadily compounding growth of Australian superannuation funds and global sovereign wealth funds seeking assets with the required scale and rates of return, and the corresponding increase in their negotiating power in both private and public deals. Brian Moynihan, Bank of America CEO who has been in Australia recently travelling with King Charles III, has predicted that the era of volatility in interest rates is coming to an end, and that US Treasuries will settle at a yield of around 4.5%.[12] While the rates driver for the move to private may have been cyclical, the power shift to the big investors is probably structural.

Consolidation has been another prominent theme. Mergers have reduced the number of listed entities (but not necessarily the market capitalisation), and on-market buy-backs have become popular with entities trading at below net asset value who want to return cash to shareholders while they wait for growth opportunities.

Although cheap capital and growing asset pools have been the leading factors in the pull to private, the regulatory burden on listed entities is an oft-cited concern. We hear frustration regarding the increasing burden of financial and governance reporting (including on new subject-matter such as climate and sustainability), the pain of the annual general meeting cycle (frequently disrupted by activists), and the class-action risk associated with continuous disclosure obligations. These and other factors can play a part in making listing on ASX seem unattractive.

DOES IT MATTER?

'De-equitisation' is not a new concept, having been first coined by a Citigroup trader 20 years ago. In 2014, Netscape founder and venture capitalist Marc Andreessen complained that tech companies not going to IPO while still small meant ordinary investors missed out on the big growth phase. Viewed in that historical context, is there a chance that the change in the balance between public and private markets could just be cyclical, and not structural?

ASIC is looking at this question, and has highlighted private markets as a priority in its latest Corporate Plan, establishing a taskforce to look at the issue over the next two years. Their first area of focus is whether they should seek more transparency in private market deals, suggesting there is the potential for participants in a private deal have an unfair informational advantage when subsequently trading in public markets. ASIC has just announced that, within weeks, it will release a discussion paper and its own research on the current state of Australia's financial markets.

12. Australian Financial Review as at 23 October 2024: https://www.afr.com/chanticleer/bank-of-america-ceo-brian-moynihan-is-calling-a-new-markets-era-20241022-p5kk60.

WHAT TO DO ABOUT IT?

The growth in private markets brings challenges and many questions for ASX, investors, policy-makers and regulators. How can public markets – especially ASX - remain viable and attractive?

First, it's worth noting that significant thought is being given to making the pathway to listing on ASX incrementally easier and more attractive.

In addition, laws that apply to listed entities, directors and officers need a regular red-tape check. Changes to make life as an ASX-listed entity a bit easier may do more to support the health of public markets than cracking down on private deals. Dr Kevin Lewis' recent review of Australia's continuous disclosure laws concluded that the requirement for knowledge, recklessness or negligence for a private action for breach of those laws to succeed should be retained (at least for now).[13] Could further reform be considered so that directors acting in good faith and not recklessly would have some protection, particularly in relation to financial and climate-reporting forecasts?

Acknowledging that passing legislation is no mean feat these days, one suggestion has been for industry bodies to advocate for a market practice of companies benchmarking their performance against a 5-year plan, more in line with the bulk of shareholders being long-term investors than a short-term results cycle. As well as taking the 24/7 heat off directors, this could encourage more long-term thinking, with obvious benefits in a world undergoing an energy transition. The thing to be avoided is an unintended consequence of regulatory change that drives a segment of activity out of the market, as arguably happened in the past with rating agencies, custody and investment advice.

A thing more likely to move the dial is, of course, money. Nobel Prize winning economist Professor Joseph Stiglitz suggested during a recent visit to Australia that tax advantages specifically for long term shareholding (longer than the 12 months currently required for the capital gains discount) could encourage long-term thinking in corporations.

Whatever the outcome, the tussle over coming years between public and private markets for the investor's dollar will be fascinating to watch.

13. See https://www.kwm.com/au/en/insights/latest-thinking/government-response-to-independent-review-on-continuous-disclosure-laws-released.html.

JAPANESE INVOLVEMENT IN LARGE M&A TRANSACTIONS:

Will the trend continue?

Increased prominence of Japanese corporates in large M&A transactions has been a feature of the Australian market in recent times. Japanese participation in Australian M&A transactions is of course not new - Japan retained its position as the 4th largest foreign investor into Australia last year. However the size of cheques the Japanese are writing and the willingness to pursue buy-out style deals is ever-increasing. We saw this trend culminate in Renesas' A$9.1 billion acquisition of KWM client Altium in early August this year. It is our bet that Japanese corporates and fund managers will have an enhanced appetite for megadeals, not just in Australia but across the region.

Renesas is no orphan amongst Japanese companies spending big on Australian M&A opportunities (think of Japan Post, Dai-ichi Life, Kirin and Mitsubishi UFJ Trust Bank to name just a few over recent years). These control deals are in addition to the many minority positions that Japanese have taken in Australian LNG and infrastructure over many years. But we now see a private capital style approach creeping into Japanese investment culture as conglomerates are de-consolidating and seeking greater sector alignment. The funds management industry in Japan is shifting in the same direction. Together with geo-economic and geo-political conditions (both in Japan and regionally), these trends are conducive to there being a greater flow of Japanese outbound investment over the medium term.

CURRENT GEO-ECONOMIC AND GEO-POLITICAL CONDITIONS ARE RIPE TO SUPPORT FURTHER GROWTH

In October, the newly elected Prime Minister of Japan met with Prime Minister Albanese at ASEAN related summit meetings in Laos. The pair confirmed the depth and length of Australia's economic relationship with Japan, the complimentary nature of the two countries' economies and the "interoperability" between Japan and Australia in the field of security. The success of the Japan-Australia Economic Partnership Agreement and its accompanying Implementing Agreement (JAEPA) perhaps best exemplifies the strength of the relationship. (The JAEPA is one of Australia's most utilised agreements with a two-way preference utilisation above 95%.)

It is no surprise that Japan is Australia's second-largest trading partner and second-largest export destination. Japanese foreign direct investment (FDI) reached $133.8 billion in the 2022 calendar year. Last year set a new record high of $141.1 billion (an increase of approximately 5.5%). The acquisition of Altium is an example of one of the mega deals in Australia; in fact one of the largest software deals in the country's history. Ultimately structured as an all-cash control acquisition, the deal is strategically important for the Japanese chip-maker, securing the Australian technology capability.

Along with other deals, Japan's stake in Australian FDI is now a very solid 12%. The Australian Trade and Investment Commission (AusTrade) reported that 53 M&A transactions and 38 partnership agreements were signed in the 2023 calendar year, where one of the parties was based out of Japan. In addition, Japanese banks continue to provide considerable debt support to Australian economic and social infrastructure and renewables projects.

Current geo-economic and geo-political conditions arguably favour even more Japanese investment in Australia and the region. Recent changes in the global geopolitical environment have, if anything brought Japan and Australia closer together, particularly in their mutual pursuit of net zero energy transition by 2050. Particular trends over recent years would support this observation, in particular the growing investment by Japanese corporates in Australian (and regional) decarbonisation projects, including in renewable energy, hydrogen and ammonia, battery energy storage systems and carbon reduction technology.

JAPANESE ASSET MANAGEMENT REFORM

Japan's funds management industry is undergoing a shift in focus from savings to wealth formation, which pushes managers to look at more alternative investment asset classes for higher returns. The allocation to offshore alternative investments has been proportionately small to date with increased allocation widely considered to be necessary to improve returns and to diversify away from yen-denominated assets.

The government has been overt in its wish for the reform of Japanese funds management to better mobilise available investment pools and increase returns for members. A key policy plank of government is to create an "asset management nation" which will require a greater focus on governance and organisational structures to support investment execution.

Japanese pension funds have seen historic inflows over the past few years. Such inflows are unlikely to continue at those levels with demographic changes and outflow commitments. They will require higher returns to maintain the capital. Japanese life insurers are also not well understood, assumed to be highly passive and preferring liquidity over returns. This is not entirely true, with investors like Dai-ichi Life taking a number of direct investments across the region on an own-account basis and allowing the subsidiaries to manage the pool fairly independently.

The question will be how these investors execute the mandate. It is most likely that they will outsource the investment capability, with Japanese money backing trusted global managers in the search for better returns. We have seen a number of examples of broad mandates being afforded to experienced managers.

We have seen marked rises in Japanese backed fund managers investing in Australian real estate, particularly in the build-to-rent sector. Australian startups and research institutions continue to be highly sought after by Japanese investors like university endowment funds looking to support regional innovation.

JAPANESE CORPORATES HAVE THE CAPABILITY (AND THE CASH)

Beyond the fund managers, there is a generational change in Japanese corporates which is bringing cultural change in the approach to investment. In the last big outbound M&A wave after the Tohoku earthquake and tsunami, Japanese corporates scoured the globe (including in Australia and Southeast Asia) for investment opportunities particularly in the financial services, energy and consumer sectors. Some of the deals they did were successful and others less so. However, what that wave showed is that Japanese corporates were committed to investing for the long term (and in long term trends). A decade on, Japanese bidders have learnt the lessons of the past and now have more than a decade of knowledge and deal experience in Australian and regional M&A. In short, Japanese corporates have the know how to do M&A and have the ability and expertise to pursue opportunities as and when it suits them.

They also have the cash to commit to big M&A transactions. Japan's population is renowned for its historically strong preference towards saving. As a country of savers and low interest rates the Japanese economy has given Japanese companies access to cheap funding to fuel international investments. The Japanese Yen has also been relatively weak. This has contributed to global funds betting big on Japan too. The comparatively weaker Yen, coupled with some robust domestic reform improving governance within large Japanese corporates, has increased foreign confidence in the Japanese equity markets. Internationally, private funds are pumping capital into the Nikkei. An increasing number of cashed up Japanese corporates are now incentivised to use that cash on acquisitions to unlock value creation.

Current domestic trends in Japan give rise to further optimism around the future for Japanese M&A in Australia and regional. The generational change generates real opportunities in areas like technology that drives productivity (for an economy that may have access to fewer workers in the long run) and healthcare domestically. While overseas, Japanese companies will look to invest in assets such as infrastructure that deliver long-term and relatively stable returns to support pensions and income streams for Japan's population.

KWM
PODCASTS

Will Heath caught up with Nicola Charlston who recently Chaired an M&A committee meeting of the International Bar Association in Tokyo - hear what she had to say about Japanese M&A insights and trends - Download the podcast here.

Download the podcast here

Spotify

JAPAN REMAINS A POPULAR SOURCE OF INVESTMENT FOR AUSTRALIA AND SOUTHEAST ASIAN NATIONS

Japan is already looking to outsource labour intensive industries and manufacturing to 'friendly' countries in Southeast Asia, as it has done for example with Thailand and Vietnam in recent times. Japan has a long history of investing in Southeast Asian businesses, putting people into the relevant country to build relationships and be a 'culture-carrier' for the parent. It largely has a good reputation as a long-term investor with successful outcomes across the region.

Australia will be well served to seek counsel from Japan as Australia seeks to increase investment into the region. It is a natural partnership in pursuit of the Australian government's policy 'Invested: Australia's Southeast Asia Economic Strategy to 2040' authored by Nicholas Moore last year. Australian businesses seeking growth into the region will see value from Japanese co-investments and are likely to benefit from government-to-government support for those efforts.

In addition, we would expect the current geo-economic and geo-political conditions that are favourable to Japanese investment in Australia and the region to continue for some time yet. Foreign investment, antitrust and other regulators generally see Japanese investors as "friendly" and reliable and, as a result, they are willing to sanction Japanese investment in, and ownership of, certain critical assets which may not otherwise be permitted to fall into the hands of other foreign owners. There are limits to this, as we are seeing in the US for example with Nippon Steel – but, as a general proposition, Japanese bidders are seen as some of the safest in the world and we would expect this view to continue into the future.

THE POWER OF JAPAN INC SHOULD NOT BE UNDERESTIMATED!

Last but not least, it would be wrong to underestimate the very influential and effective work that Japanese government policy and 'Japan Inc' can do in driving whole-of-economy initiatives in Japan. An example of Japan Inc in operation is the shift to hydrogen. The shift to hydrogen and the hydrogen supply chain will offer long term opportunities for parties in Australia and regionally.

As we look to the future, it is clear that Japanese investors will continue to play a significant role in shaping both Australia's and the broader region's economic landscape and we would definitely anticipate that this 'shaping' could very well be undertaken through increased Japanese corporate participation in big ticket M&A transactions.

PUBLIC M&A MARKET ON A PAGE – NOVEMBER 2024[14]

NUMBER OF DEALS

41

AGGREGATE DEAL VALUE

A$44.1B

STATUS

25	3	3	10
SUCCESSFUL	UNSUCCESSFUL	WITHDRAWN	CURRENT

FEATURES

AVERAGE NUMBER OF DAYS FROM ANNOUNCEMENT TO COMPLETION[15]

120

SUCCESSFUL DEALS WITH A PRE-BID STAKE

8

AVERAGE SIZE OF PRE-BID STAKE

32.5%

14. The statistics on this page are for deals announced between 1 January 2024 and 30 September 2024 where the target is or was listed on the ASX and the deal value is $50 million or more. The value of the Alcoa/Alumina deal is based on the announced closing value of the transaction of approximately US$2.8 billion.
15. For a takeover, completion is considered achieved once the bidder has a relevant interest of at least 90%. For a scheme, completion is considered to occur on the implementation date.

10 LARGEST PUBLIC DEALS IN 2024 SO FAR

Target	Bidder	Deal value	Sector
Boral Limited	Seven Group Holdings Limited	A$12.45 billion	Materials
Altium Limited	Renesas Electronics Corporation	A$9.09 billion	Software & Services
CSR Limited	Compagnie de Saint-Gobain	A$4.32 billion	Materials
Alumina Limited	Alcoa Corporation	A$4.2 billion	Materials
PSC Insurance Group Limited	The Ardonagh Group	A$2.26 billion	Insurance
Adbri Limited	Barro Group Pty Ltd	A$2.10 billion	Materials
Silver Lake Resources Limited	Red 5 Limited	A$1.38 billion	Metals & Mining
APM Human Services International Limited	Madison Dearborn Partners, LLC	A$1.33 billion	Commercial & Professional Services
MMA Offshore Limited	Cyan Renewables Pte. Ltd.	A$1.03 billion	Energy
Hotel Property Investments	Charter Hall Retail REIT and Hostplus	A$718.22 million	Equity Real Estate Investment Trusts (REITs)

THE M&A IN THE CITY TEAM

NICOLA CHARLSTON

PARTNER
MELBOURNE

TEL +61 3 9643 4366
MOB +61 412 840 759
EMAIL nicola.charlston@au.kwm.com

DAVID FRIEDLANDER

CHAIR
SYDNEY

TEL +61 2 9296 2444
MOB +61 417 922 444
EMAIL david.friedlander@au.kwm.com

WILL HEATH

PARTNER
MELBOURNE

TEL +61 3 9643 4267
MOB +61 415 603 240
EMAIL will.heath@au.kwm.com

DANIEL NATALE

PARTNER
SYDNEY

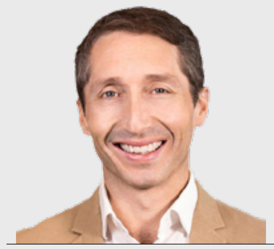
TEL +61 2 9296 2755
MOB +61 408 869 681
EMAIL daniel.natale@au.kwm.com

ANTONELLA PACITTI

PARTNER
PERTH

TEL +61 8 9269 7094
MOB +61 409 814 215
EMAIL antonella.pacitti@au.kwm.com

MEDIA ENQUIRIES



JAMES BENNETT

CORPORATE AFFAIRS MANAGER
MELBOURNE

TEL +61 3 9643 5338
MOB +61 476 009 133
EMAIL james.bennett@au.kwm.com

CLIENT ENQUIRIES

BROOKE CUMMINS

CLIENT RELATIONSHIP MANAGER
SYDNEY

TEL +61 2 9296 3183
MOB +61 479 098 468
EMAIL brooke.cummins@au.kwm.com

CONTRIBUTORS

MARK VANDERNEUT

PARTNER
SYDNEY

TEL +61 2 9296 2318
MOB +61 400 939 451
EMAIL mark.vanderneut@au.kwm.com

PETER STIRLING

PARTNER
MELBOURNE

TEL +61 3 9643 4063
MOB +61 419 248 787
EMAIL peter.stirling@au.kwm.com

NICOLA YEOMANS

PARTNER
SINGAPORE

TEL +65 6991 6538
MOB +65 8339 5896
EMAIL nicola.yeomans@sg.kwm.com

CHRISTOPHER KOK

PARTNER
SYDNEY

TEL +61 2 9296 2518
MOB +61 400 720 426
EMAIL christopher.kok@au.kwm.com

GLENDA HANSON

CONSULTANT
SYDNEY

TEL +61 2 9296 2377
MOB +61 429 150 927
EMAIL glenda.hanson@au.kwm.com

JOE SAUNDERS

SENIOR ASSOCIATE
CANBERRA

TEL +61 2 6217 6053
MOB +61 410 529 737
EMAIL joe.saunders@au.kwm.com

JOE MCQUILLEN

SENIOR ASSOCIATE
MELBOURNE

TEL +61 3 9643 4083
MOB +61 436 276 611
EMAIL joe.mcquillen@au.kwm.com

GENOVIEVE LAJEUNESSE

SENIOR ASSOCIATE
SYDNEY

TEL +61 2 9296 2539
MOB +61 427 587 309
EMAIL genovieve.lajeunesse@au.kwm.com

JACOB CARMODY

SENIOR ASSOCIATE
PERTH

TEL +61 8 9269 7073
MOB +61 427 592 484
EMAIL jacob.carmody@au.kwm.com

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