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Private Equity

HORIZONS 2017 MID-YEAR UPDATE

The first-half of 2017 has been one of the most active buy-out periods for private equity in Australia since the financial crisis. With fundraising conditions remaining positive, plenty of committed capital needing to be invested and the announcement of a number of large and high-profile transactions involving financial sponsors, we believe that PE activity will remain robust for the remainder of the year.

The first-half of 2017 has been one of the most active buy-out periods for private equity in Australia since the financial crisis. On the back of this activity, members of Allens' PE team recently travelled to London to meet with global PE funds and our alliance firm, Linklaters, to discuss the cadence of the international PE market and what opportunities they see for sponsors in Australia going forward. In summary, with fundraising conditions remaining positive, plenty of available committed capital needing to be invested and the announcement of a number of large and high-profile public transactions involving financial sponsors, we believe that private equity activity will remain robust for the remainder of the year.

These are our top trends and predictions for the second half of 2017.

1 AUSTRALIA IS LOOKING INCREASINGLY ATTRACTIVE TO LARGE GLOBAL FUNDS (NOTWITHSTANDING A CHALLENGING INVESTMENT ENVIRONMENT)

In the first-half of 2017 we saw a number of large global funds become increasingly active on the buy-side, albeit with mixed success. On the one hand, Advent International made a significant investment in Australia (via its portfolio company Culligan International), Bain Capital acquired after school care provider Camp Australia and KKR acquired leading bar and restaurant operator, Dixon Hospitality. On the other, and following a significant period of due diligence, we saw both TPG and Hellman & Friedman withdraw their respective offers to take Fairfax Media private.

Although the relatively few opportunities to deploy large equity cheques continues to be one of the main challenges facing global funds wanting to invest in Australia, we believe that there are a number of factors which will support PE activity from large funds in the second half of 2017 – the uncertain political climate in the northern hemisphere, less red tape for foreign investors with the introduction of 'exemption certificates' from FIRB and record amounts of dry powder suggests that the larger domestic funds will face increasing competition on the buy-side from the leading global players.

2 PUBLIC-TO-PRIVATE TRANSACTIONS WILL BECOME MORE COMMON AND BUILD MOMENTUM FOR FURTHER M&A

The conditional proposals from KKR and Affinity to acquire listed telecommunications provider Vocus, KKR Credit's conditional proposal to acquire Pepper Group and the now withdrawn offers from TPG and H&F to acquire Fairfax Media shows that the appetite for public-to-private transactions is strong – and these are the ones in the public domain. Although take-privates are currently expensive on the whole in Australia, the number of offers in the market at the moment suggests that sponsors are seeing selective opportunities to acquire good businesses which, for various reasons, are trading at reasonable or attractive valuations in the listed market.

Given the size, complexity and high-profile nature of acquiring a business such as Vocus or Fairfax Media, we think that this has the potential to build broader momentum and encourage other sponsors to pursue opportunities where they may have otherwise held back.

In connection with these transactions, we expect the inclusion of rollover equity (as an alternative to cash) to become increasingly popular as sponsors try to bridge the value gap and convince target boards to recommend their offer notwithstanding the fact that certain significant shareholders may not be willing to sell their shares for cash. PEP's acquisition of Patties Foods by scheme of arrangement in 2016 is the most recent precedent transaction to have adopted this structure.

3 THE 'BUY-AND-BUILD' STRATEGY WILL REMAIN THE PE VALUE CREATION STRATEGY OF CHOICE

In recent years we have been seeing the 'buy-and-build' strategy become the PE value creation strategy of choice. It was therefore no surprise that in the first-half of 2017 a number of acquisitions contemplated either an add-on to an existing portfolio company (for example, PEP's acquisition of Allied Mills and Advent International's acquisition of Zip Water) or a 'platform acquisition', where a target company is acquired for the purpose of being used as a platform for further growth through bolt-on acquisitions (for example, KKR's acquisition of Dixon Hospitality).

4 POSITIVE FUNDRAISING CONDITIONS WILL CONTINUE TO DRIVE ACTIVITY (ALTHOUGH TRANSACTIONS WILL BE HARD TO EXECUTE)

It is no secret that low interest rates around the world have encouraged investors to seek greater returns through private markets. As such, after a strong year for PE fundraising in 2016 for both PE and infrastructure focused funds, 2017 has seen a strong start with a number of global and domestic funds having recently closed record funds, while others are currently in the process of marketing to investors.

These positive fundraising conditions mean that sponsors have significant amounts of capital to deploy, which should result in healthy activity on the buy-side. However, the first-half of 2017 demonstrated that increased activity does not necessarily mean that sponsors will find it easier to complete transactions. The number of deals which failed to complete, notwithstanding strong interest from sponsors (and, in some cases, an extensive period of due diligence), suggests that company boards will continue to approach interest from sponsor bidders with a degree of caution.

Further, notwithstanding the challenging exit conditions in terms of listed markets, we are seeing a number of sponsors commence exit preparations for investments held in vintage funds in order to show material realisations with a view to securing new commitments from limited partners.

5 TECHNOLOGY, HEALTH AND AGRI & FOOD WILL REMAIN THE SECTORS TO WATCH

As we predicted in our *Private Equity Horizons 2017* publication, the key sectors where sponsors are showing the most appetite are Agri & Food, Health and Technology. Unsurprisingly, staple sectors such as Health and Agri & Food continue to be of interest to both local and domestic funds who are either growing existing investments through market consolidation and/or seeking opportunities to rationalise existing businesses and take advantage of favourable global demographic trends by penetrating into new markets. Technology businesses (particularly anything cyber-security related and businesses which contain broad data) continue to remain high in demand also.

6 IPO MARKETS REMAIN CHALLENGING

IPO markets have remained challenging for PE exits in 2017 to date. This has not been specific to PE but related to general IPO market conditions and investor sentiment, particularly in certain sectors such as retail. A number of highly-publicised potential PE exits via IPOs (including Zip Water, Accolade Wines, Alinta Energy, Retail Apparel Group and Craveable Brands) were all put on hold in the first part of 2017 and some were subsequently sold via trade sale. Added to this trend, we have seen other high profile IPOs delayed, such as Officeworks or the Crown Resorts hotel spinoff, and the fact that only one IPO in 2017 has raised more than $400m (Bingo). The IPO market is not necessarily closed; rather there is a bridge to cross in pricing expectations between sellers and investors. As a result, PE sponsors may, in the near term, see a bias towards trade sales, longer hold periods, secondary sales to other sponsors, or more dividend recapitalisations as preferred exit routes as opposed to IPOs.

In the secondary space, we have seen several block trades in the market in 2017 by sponsors following the end of escrow arrangements, such as the sale of Bain Capital's MYOB block. Others post-escrow blocks that the market will be watching during the second half of 2017 include those held by sponsors in Inghams, Bravura Solutions and GTN.

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DEAL LIST:

Our deals in the first half of 2017:

- **Vocus** – Advising Vocus Group on its response to separate $3.3 billion proposals from Kohlberg Kravis Roberts & Co LP and Affinity Equity Partners to acquire 100% of the shares in Vocus.
- **Advent International** – Advised Advent International and its portfolio company Culligan International on its acquisition of the Australian taps and water systems business, Zip water.
- **Dixon Hospitality** – Advised Dixon Hospitality on its acquisition by KKR.
- **Patties Foods** – Advised Pacific Equity Partners-backed Patties Foods on the acquisition of New Zealand-based food business Leader Foods.
- **Patties Foods** – Advised Pacific Equity Partners-backed Patties Foods on the acquisition of South Australian meal solutions business Australian Wholefoods.
- **Hastings Funds Management and First State Super** – Advised a consortium led by Hastings Funds Management and First State Super on its intra-consortium and equity arrangements in relation to its successful $2.6 billion bid to operate a 35-year concession of the land titling and registry operations of New South Wales Land and Property Information.
- **QAF** – Advising QAF on the strategic review of its primary production business (Rivalea) in Australia.
- **Future Fund Board of Guardians** – Advised Australia's sovereign wealth fund on numerous private equity co-investments across a range of sectors.
- **Bain Capital** – Advised Bain Capital Private Equity on its acquisition of Camp Australia, a leading provider of outside school hours care programs.

CONTACTS

Tom Story
Partner – Co Head of Private Equity
T +61 2 9230 4812
M +61 404 024 526
Tom.Story@allens.com.au

Mark Malinas
Partner – Co Head of Private Equity
T +61 3 9613 8485
M +61 409 389 789
Mark.Malinas@allens.com.au

Emin Altiparmak
Partner – Sponsors
T +61 3 9613 8510
M +61 417 995 445
Emin.Altiparmak@allens.com.au

Julian Donnan
Partner – Co-Head Equity Capital Markets
T +61 2 9230 4113
M +61 420 928 181
Julian.Donnan@allens.com.au

Robert Pick
Partner – Co-Head Equity Capital Markets
T +61 3 9613 8721
M +61 413 440 230
Robert.Pick@allens.com.au

Jo Folan
Partner – Finance
T +61 2 9230 4625
M +61 410 096 302
Jo.Folan@allens.com.au

Mark Kidston
Partner – Finance
T +61 2 9230 4419
M +61 405 135 419
Mark.Kidston@allens.com.au

Noah Obradovic
Senior Associate – Sponsors
T +61 3 9613 8815
M +61 451 230 567
Noah.Obradovic@allens.com.au

Apoorva Suryaprakash
Senior Associate – Sponsors
T +61 2 9230 4402
M +61 466 587 885
Apoorva.Suryaprakash@allens.com.au