Allens > < Linklaters

Private Equity

HORIZONS 2018 MID-YEAR UPDATE

Private equity continued its robust run in the first half of 2018, underscored by high levels of dealmaking and a supportive fundraising market. Most significantly, the first half of 2018 has seen a flurry of public-to-private activity that should continue to keep dealmakers busy for the remainder of the calendar year. However, the mountain of dry powder competing for limited quality investment opportunities remains an issue that has prompted a diversification in the capital-deployment strategies for Australian-focused managers.

www.allens.com.au

A shift towards public market transactions

Consistent with the predictions in our *Private Equity Horizons 2018* publication, the first half of 2018 has seen a continued resurgence in public-to-private transactions, with financial sponsors attempting to make investments in listed businesses that are trading at reasonable or attractive valuations. Some of the noteworthy announcements of public-to-private transactions over the first half of this year include:

- the proposed acquisition of Healthscope Limited by a consortium led by BGH Capital and subsequent proposal by Brookfield;
- CDH Investment's proposal to acquire Sirtex Medical Limited;
- Blackstone's proposed acquisition of Investa Office Fund;
- the proposed Bain Capital-led management buyout of BWX Limited;
- PEP's successful acquisition of LifeHealthcare Limited via scheme of arrangement; and
- Oaktree's successful acquisition of Billabong International, via its portfolio company, Boardriders, Inc.

Although public-to-private transactions in Australia involving PE sponsors have had a chequered history, PE sponsors are acutely aware of the fact that record fundraising levels are only sustainable when there are genuine opportunities to deploy capital. Increased competition between both financial sponsors and cashed-up strategic acquirers hungry for growth opportunities through acquisitions has seen correlating increases in asset prices as sponsors battle for investments. Facing limited opportunities in the unlisted markets and increased competition for good quality assets, sponsors have actively sought to deploy capital by turning to listed targets.

Sponsors can expect to pay significant premiums for listed targets. Our research indicates that where due diligence is granted, the average offer multiple is around 9 times EV/LTM EBITDA and a 32% premium to last close (or the last undisturbed share price).

Factors driving public-to-private transactions

A number of important factors are driving private equity's interest in listed Australian companies. The key drivers are:

1 DEAL DYNAMICS

There is a perception that listed targets are becoming increasingly accessible to sponsors, with a number of completed take private deals suggesting that public-to-private transactions are becoming easier to execute. Almost 40% of public transactions involving private equity acquirers since 2007 have taken place after the half-way point of 2016, suggesting that target boards are becoming increasingly receptive to entertaining genuine offers from private equity acquirers. This was very clearly demonstrated when CDH Investments made a $1.9 billion bid for medical device maker Sirtex Medical just one working day before Sirtex shareholders would vote on a rival offer of $1.6 billion from trade buyer Varian. The nearly 80 per cent premium to last close before the Varian offer was announced was enough to convince the target board to recommend the more risky private equity bid, which included a $200 million reverse break fee/deposit in the event that certain regulatory hurdles were not cleared.

2 FEWER INVESTMENT OPPORTUNITIES

In the first half of 2018 we have seen a more limited number of privately run auction processes compared to previous years. Although the year started with the sale of I-MED Radiology Network from EQT Partners to another European-based manager, Permira, for a reported $1.25 billion, the remainder of the first half could not keep pace, with most private M&A transactions centered around small-to-mid-market deals. One of the largest PE transactions in the first half of the year was Carlyle's acquisition of Accolade Wines from Champ, which reportedly delivered a very successful return for the seller. Other notable transactions included Australia's most active manager, Quadrant, acquiring confectionary manufacturer Darrell Lea and selling its interest in CQMS Razer to US-based private equity fund American Industrial Partners. Given that local sponsors are now deploying larger equity cheques than they have in the past, the limited number of private companies for sale that meet minimum equity cheque criteria has encouraged sponsors to target listed companies, which potentially allows sponsors to avoid the auction process and negotiate a transaction on a bilateral basis.

3 PUBLIC M&A ACTIVITY

There was a resurgence in public M&A activity over the back end of 2017 and first half of 2018 (both on the sponsor and corporate side), which is building confidence more generally. Despite the rebuttal of high-profile tilts, including for Santos (by a consortium led by Harbour Energy) and Healthscope (which rejected two separate proposals from consortia led by BGH Capital and Brookfield), public M&A acitivty levels are currently at a seven-year high, buoyed by mega deals such as Unibail-Rodmaco's $US30.9 billion acquisition of Westfield and CKI Group's $13 billion proposed takeover of APA. On the sponsor side, the announcement of large public-to-private proposals from BGH Capital, Bain Capital, PEP and others in the past 12 months is likely to encourage other sponsors to step forward.

4 CONSORTIA

Bidders are increasingly prepared to form consortia involving private equity, superannuation funds and/or cashed-up corporates, making it easier to acquire larger listed targets. In the first half of 2018 we saw a consortium comprised of BGH Capital, AustralianSuper, GIC, CPPIB and OTPP make a $6 billion proposal to acquire Healthscope. Bain Capital's proposal to take hair and skincare company BWX private saw private equity partner with the existing senior management team of the target. Sponsors have shown a desire to incorporate extensive exclusivity arrangements with their consortium parters in order to increase the competitive strength of the proposal.

5 DEBT FUNDING

Flexible and more attractive funding structures are becoming more common and improving the overall economics of take private transactions. The advent of the unitranche loan is changing the Australian debt market, and appears to be here to stay, as the local market is developing its own profile and applying significant pressure on traditional bank financings. Highly confident letters remain generally sufficient to enable private equity bidders to obtain access to due diligence information in a public-to-private context.

The year ahead

With the first half of 2018 characterised by private equity's enthusiasm for approaching listed targets – and the competition for assets unlikely to abate – we think that there is a good chance this momentum will continue through the year. However, the large number of deals announced in the first half of 2018 that did not materialise shows that execution risks remain. Santos' rejection of Harbour Energy's revised proposal caught many market participants (including the bidder) by surprise, and the ATO's decision to reject AMA Group's request for a ruling for demerger relief – which was a condition precedent to the take private proposal from Blackstone – are evidence that execution and regulatory risks remain high for public-to-private transactions.

What about public markets exit opportunities?

While IPO markets have recently been challenging for private equity exits, with sponsors preferring trade and secondary sales as exit routes, there are indications that the resurgence of sponsors in the public markets may extend to a return to exits via IPO. Most notably, the $2.65 billion listing of fuel refiner, distributor and retailer Viva Energy (majority owned by global commodities trader Vitol Group), is one of Australia's largest-ever public listings, and potentially signals a thawing in Australia's equity capital markets for the right assets. It will be interesting to see how private equity owned Latitude goes in the second half of the year.

Deal list

Our deals in the first half of 2018:

- **BGH Consortium** – advising a consortium comprised of BGH, AustralianSuper, Canada Pension Plan Investment Board, Ontario Teachers' Pension Plan and GIC, in relation to the proposed $6 billion take private of Healthscope Limited, one of Australia's largest ever private equity transactions.
- **Bain Capital** – advising on its $803 million offer for branded skin and hair care products company BWX Ltd.
- **Pacific Equity Partners** – advised Pacific Equity Party on its acquisition of ASX-listed LifeHealthcare Group Limited by scheme of arrangement.
- **Investa Office Fund** – advised IDF in response to the $3.11 billion proposal from Blackstone Real Estate.
- **Billabong International** – advised on the sale of Billabong International to Boardriders (controlled by funds managed by Oaktree Capital Management) by way of scheme of arrangement.
- **The Future Fund Board of Guardians** – advised Australia's sovereign wealth fund on numerous private equity co-investments across a range of sectors.
- **Cerberus Capital Management** – advised Cerberus Capital Management on its acquisition of the Australasian mortgage lending and portfolio servicing operations of Bluestone Group.
- **Australian Venue Co Limited (formerly Dixon Hospitality Limited)** – advised AVC and KKR on numerous bolt-on acquisitions (including the Keystone Group and the Publican Group).

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
Managing Associate – Sponsors
T +61 2 9230 5301
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