GILBERT + TOBIN

COVID-19 MERGERS + ACQUISITIONS IN A TIME OF CRISIS

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Since the onset of the coronavirus (COVID-19) pandemic, the world has changed in a dramatic way and at a significant pace. The Australian economy, and indeed the global economy, has been severely impacted. The short to medium term seems very uncertain. Stock markets have rapidly declined. While as at the time of writing they have recovered some lost ground, they remain subject to extreme volatility.

This all makes M+A hard.

The impact of the pandemic on company turnover and earnings means many companies will have urgent funding needs. However, on the flip side, those with cash and liquidity will see opportunities emerge. Many Australian companies are not overleveraged and have healthy balance sheets (unlike in the global financial crisis) and private equity can access billions in available cash.

We provide an overview and some comments on the current Australian M+A and equity capital market landscape and what we're seeing in real time. We trust you find these insights useful.

M+A IN THE SHORT TERM

Business conditions are uncertain. Many would say that is an understatement.

The rapid onset of the pandemic across the globe has had a chilling effect on M+A in the short term.

Various public M+A deals in negotiation have been put on hold or, in some cases, ceased altogether as the target's future earnings and valuation is difficult to assess. For example:

+ some competitive auction/sale processes, which at one time had multiple engaged bidders, have been delayed or left in limbo (eg Owens Illinois' ANZ business, Laureate Education, Village Roadshow, Caltex and the WA Government sale of WATAB). We're also aware of various confidential transactions in advanced stages of negotiations which did not proceed due to the uncertainty; and

M+A IN THE SHORT TERM (CONT.)

+ some non-binding indicative offers have been withdrawn (eg multiple proposals by trade and private equity for National Storage REIT) while others have received a flat rejection (eg Partners Group/Healius, Strike Energy/Warrego Energy).

In addition, some announced public deals the subject of binding transaction documents have:

+ been terminated in reliance on conditions (eg Starwood Capital Group's proposed takeover of Australian Unity Office Fund, due to a breach of offer conditions prohibiting new financing and the proposed acquisition of Abano Healthcare by private equity due to the material adverse change clause albeit there is a suggestion in the announcement of a potential to renegotiate the deal); or
+ otherwise slowed down and/or are reportedly looking shaky (eg Pioneer Credit/Carlyle, Liquefied Natural Gas and Metlifecare/Asia Pacific Village Group).

This is of course also happening overseas. One high profile example was Xerox and Carl Icahn recently terminating its 5 month long US$34 billion unsolicited tender offer to acquire HP.

We are also aware of a number of private deals that will not proceed or will be revisited in 3 to 6 months' time when more information on the impact of the virus is known.

We expect to see more reluctant acquirers seeking to withdraw from deals based on material adverse change, stock market fluctuation and other conditions. Alternatively, if not withdrawing altogether, they may use these conditions as a basis to renegotiate a more favourable deal reflective of the new norm of lower asset prices. See page 35 of our *2020 Takeovers + Schemes Review* (Review) for a further discussion of conditions in public M+A.

For those small number of deals that are ongoing, or as the world stabilises and more acquirers actively engage in M+A again, we expect even greater emphasis on commercial diligence on maintainable earnings and a laser-like focus on the specific terms of material adverse change, financing and other conditions.

OPPORTUNITIES FOR M+A

That said, for those with cash and liquidity (particularly many private equity firms), the stock market decline and deteriorating economic conditions will provide a range of attractive opportunities to pick up companies at much lower valuations. The key for both target boards and acquirers alike is determining the point where the markets have stabilised, and sensible conversations can be had about valuation. We are certainly not at that point yet.

For those private equity firms who have recently raised funds or who have a large amount of unused funds, it's the perfect time in the investment cycle to be investing. That said, the economic and social uncertainty and the likely prospect of a recession make proceeding with acquisition and investment opportunities a tough call. However, fortune often favours the brave. Indeed, some with memories of the global financial crisis might consider they did not move quickly or hard enough as the world rebounded from those difficult times. The second half of 2020 and into 2021 may provide a similar opportunity. See more on PE bids in 2019 on page 7 of our Review.

Australian superannuation funds also retain significant amounts of funds to expend. This may further enhance their willingness over the last few years to become actively involved in M+A including in public M+A – see more on superannuation funds in public M+A on page 4 of our Review. Indeed, having regard to the additional FIRB restrictions (see further below), Australian superannuation funds have a terrific opportunity to be the financial victors of these times.

For now, it will be relatively easy for companies, especially those who are financially stable, to rebuff unsolicited takeover approaches on the basis that they are opportunistic such as Healius did in respect of Partners Group's $2.1 billion approach.

However, outright rejections by those with short term cash needs will not be so easy. They might need to seek buyers for all or part of their business or cede control to a supportive investor (perhaps by way of convertible notes – see further below) to survive. The need for cash makes the accessibility of equity capital markets critical to the ability of a potential target company to survive on a stand-alone basis.

One thing is for sure: as and when stock markets stabilise and companies can see a pathway through to the end of the COVID-19 pandemic, we can expect to see unsolicited confidential approaches, bear hugs and maybe even a few unsolicited takeover bids.

EQUITY CAPITAL MARKETS

The impact of COVID-19 on Australia's economy means that many entities will need to assess all available means of accessing funding to alleviate a cash flow squeeze resulting from declining sales and operational closures and to avoid debt levels falling outside acceptable levels. Clearly, we'll see many equity capital market raisings in the months to come (see our publication Raising Capital in the Age of Coronavirus: Key considerations for issuers and underwriters and lessons from the GFC by Adam D'Andreti, Peter Cook and Rachael Bassil).

Some companies have already successfully turned to the equity markets, including hearing implant company Cochlear ($930 million placement and SPP), outdoor media specialist oOh!media ($167 million placement and pro rata entitlement offer), IDP Education ($240 million placement and SPP), Kathmandu ($200 million placement and rights offer) and Webjet (over $300 million placement and rights issue) amongst others. NEXTDC is also seeking to raise over $670 million in an institutional placement to fund growth. While not equity, interestingly Transurban recently raised over $1 billion from foreign bond markets.

As one would expect in these times, many of the capital raisings are being undertaken at a significant discount to the last closing price.

Others the media report as potentially needing to undertake an equity raising include Flight Centre, James Hardie, Link, Ramsay Health Care, Sydney Airport, Woodside and Vocus. Common amongst these lists are companies in the aviation, tourism, leisure and education sectors which we all know have been hit hard.

ASX and ASIC have also moved quickly to introduce temporary relief measures which are designed to help facilitate successful equity capital raisings by ASX-listed entities, as discussed further below.

Those entities that need equity funding but cannot access equity markets or investment bank underwriting may need to either seek comfort closer to home and have major shareholders underwrite (or backstop) capital raisings (with the complications this may give rise to for control of the company).

Alternatively, they may need to look further afield for a convertible note raising or PIPE (private investment in public equity) from private equity as Webjet reportedly did before it got its equity raising away at the second attempt. We know others are considering convertible note instruments. Superannuation funds may also have a role to play here. For example, last year AustralianSuper supported Syrah Resources with a convertible note issue. These types of issues can be a win-win, particularly where the investor has some strategic benefit to offer the investee company and for the investor getting equity upside with debt style protections.

However, when deciding on the timing and structure of any capital raising, ASIC expects directors to balance the need for capital with the potential dilution of existing shareholders. Where circumstances allow, pro rata rights offers and SPPs can help achieve fairness. Given the volatile swings in equity markets, and also having regard to recently announced ASX and ASIC regulatory relief, we expect that capital raising structures with short risk periods for underwriters will be preferred. That is institutional placements (with non-underwritten SPPs to manage dilution of retail holders) and non-renounceable entitlement offers.

RESTRUCTURING... AND EVEN NATIONALISATION

For some, it will be just too hard to access traditional equity and debt markets.

Sadly, for many of those, we'll see them face administration or receivership, notwithstanding the Government's temporary relaxation of the insolvent trading rules (see our publication COVID-19 Temporary Relief for Financially Distressed Businesses). We expect to see significant restructures including in retail eg Kikki.K has started what could be a long list in the second half of 2020 and into 2021. We also expect to see distressed debt funds taking advantage of these times to acquire loans of overleveraged companies at a discount as a means of controlling or influencing their future ownership.

> Again, this will create opportunities for buyers with cash to acquire businesses and assets that were previously not for sale.

For others, that are considered essential services or industries, the Government may need to step in to provide funding. In recent days the media has reported that the Government may need to do this for some companies in the aviation sector on terms that might include conversion into equity if debt funding is not repaid in 2 or 3 years. We have not seen this in Australia in recent times, but there are various precedents out of the global financial crisis including UK banks and the US motor industry and banks

FOREIGN INVESTMENT

As discussed above, many developments are occurring quickly. Indeed, one such development was the Treasurer's stunning announcement at 10.30pm last Sunday night that:

+ the monetary thresholds for foreign investment proposals covered by the *Foreign Acquisitions and Takeovers Act 1975* (Cth) would be reduced to zero; and
+ the Foreign Investment Review Board (**FIRB**) would be seeking to extend the deadlines for applications for up to six months (albeit most applications are not expected to take that long).

Why is the Australian Government doing this?

The FIRB website states in Q&A that "*Australia is being fundamentally disrupted by the coronavirus, including potentially threatening economic security and the viability of critical sectors. Businesses are increasingly under pressure. There will likely be a rise in debt restructuring transactions for Australian businesses, along with opportunities to invest in distressed assets. Without these changes, it is possible many normally viable Australian businesses would be sold to foreign interests without any government oversight, presenting risks to the national interest.*"

The changes have the potential to slow down foreign takeovers and provide a comparative advantage for Australian acquirers (including corporates and superannuation funds) who can move more quickly. This will particularly be the case if FIRB becomes overwhelmed with processing applications due to the lower threshold. We're starting to see some smaller deals fall over as the cost and time of going through the FIRB process makes the transaction too difficult at these times. This should be addressed as Australia cannot afford not to be open for business.

That said, it seems a defensible decision to protect Australian companies from foreign raiders at a time of uncertainty, provided that welcome foreign investment in the national interest is allowed to progress quickly. Indeed, the Treasurer has stated that the investment will be fast tracked if it will preserve Australian jobs.

It will be interesting to see if the longer time periods result in foreign investors providing debt funding as an interim step to an equity investment while awaiting FIRB approval for the equity investment. For more on FIRB, see our publication New rules on foreign investment under FATA by Deborah Johns and also pages 16-19 of our Review for other developments in 2019.

FACILITATIVE REGULATORY APPROACH

These difficult times have also seen a proactive approach by regulators to be facilitative of proposals to improve the effective operation of financial markets and access to liquidity where it makes sense. These include:

- **Increased placement capacity** – the relaxation of the ASX listing rules to allow for a temporary increase (until at least 31 July 2020) in placement capacity up from 15% to 25% of the share capital if there is a follow on SPP or an entitlement offer made at the same time. The Webjet placement has already taken advantage of this change;
- **Greater opportunity for low doc offers** – ASIC's provision of temporary relief to enable "low doc" offers (including rights offers, placements and SPPs) to still be made by listed companies who have been suspended for a total of up to 10 days in the previous 12-month period (up from a total of 5 days) in circumstances where their longer suspension has occurred after the escalation of Government measures introduced to manage the spread of COVID-19;
- **Back to back trading halts** – entities will be able to request back-to-back trading halts (ie a total of four days in halt) to consider and prepare for capital raisings;
- **Larger non-renounceable entitlement offers possible** – the ratio limit of 1:1 for non-renounceable entitlement offers has been removed;
- **AGMs in the social distancing age** – ASIC's sensible approach to temporary relief in holding annual general meetings in these times of social distancing; and
- **ACCC authorisation of competitors working together to benefit the community** – the ACCC's willingness to temporarily authorise companies (including the banks and the major supermarkets) to work together where doing so will deliver benefits to the public, particularly relating to continuity of service. The ACCC has established a dedicated COVID-19 taskforce and is being very responsive to issues as they arise – it has also noted that it will seek to minimise regulatory burden in its enforcement activities more generally, as far as possible.

The impact of some of the capital raising reforms may result in excessive dilution to existing shareholders and directors will be conscious of this.

For further information on these matters, see our publication ASX and ASIC introduce emergency reforms in response to the impact of COVID-19 on ASX-listed entities by Adam D'Andreti and our publication ASIC facilitates 'social distancing' in AGMs by Kevin Ko.

Of course, that is not to say that the regulators won't carefully scrutinise any contentious matters where they arise. They will certainly be mindful that they will be judged with 20:20 hindsight for the transactions they let through, as occurred with certain mergers during the global financial crisis. As we highlighted in our Review – they have been tough in recent times: see pages 39 - 46 of the Review.

These are unprecedented times indeed. As noted, there will be many challenges ahead, but we also expect that attractive opportunities will arise before long, particularly with the lower asset valuations.

If you would like to explore any of the above matters or other corporate, M+A and ECM matters (whether by phone or via a webinar with your team), please contact us at any time.

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