KING&WOOD MALLESONS
金杜律师事务所

M&A IN THE CITY

2024

Port by Jane Hoggard

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

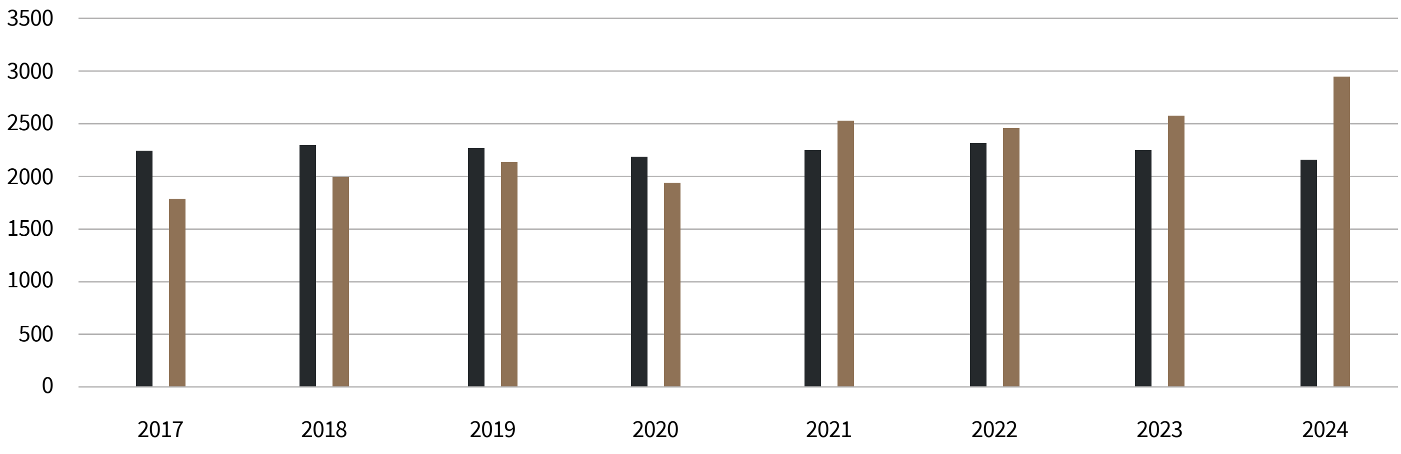
A$3.5t
SUPERANNUATION SECTOR

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.

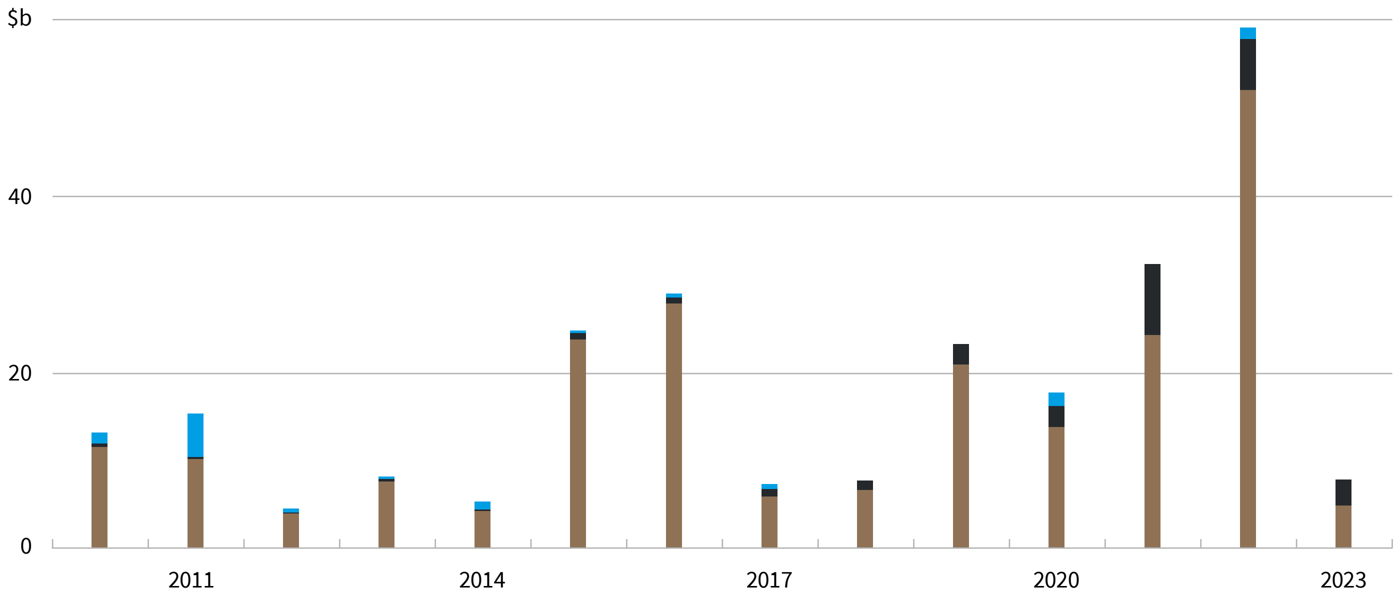
BY CONTRAST... THE GROWTH IN PRIVATE DEALS

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.

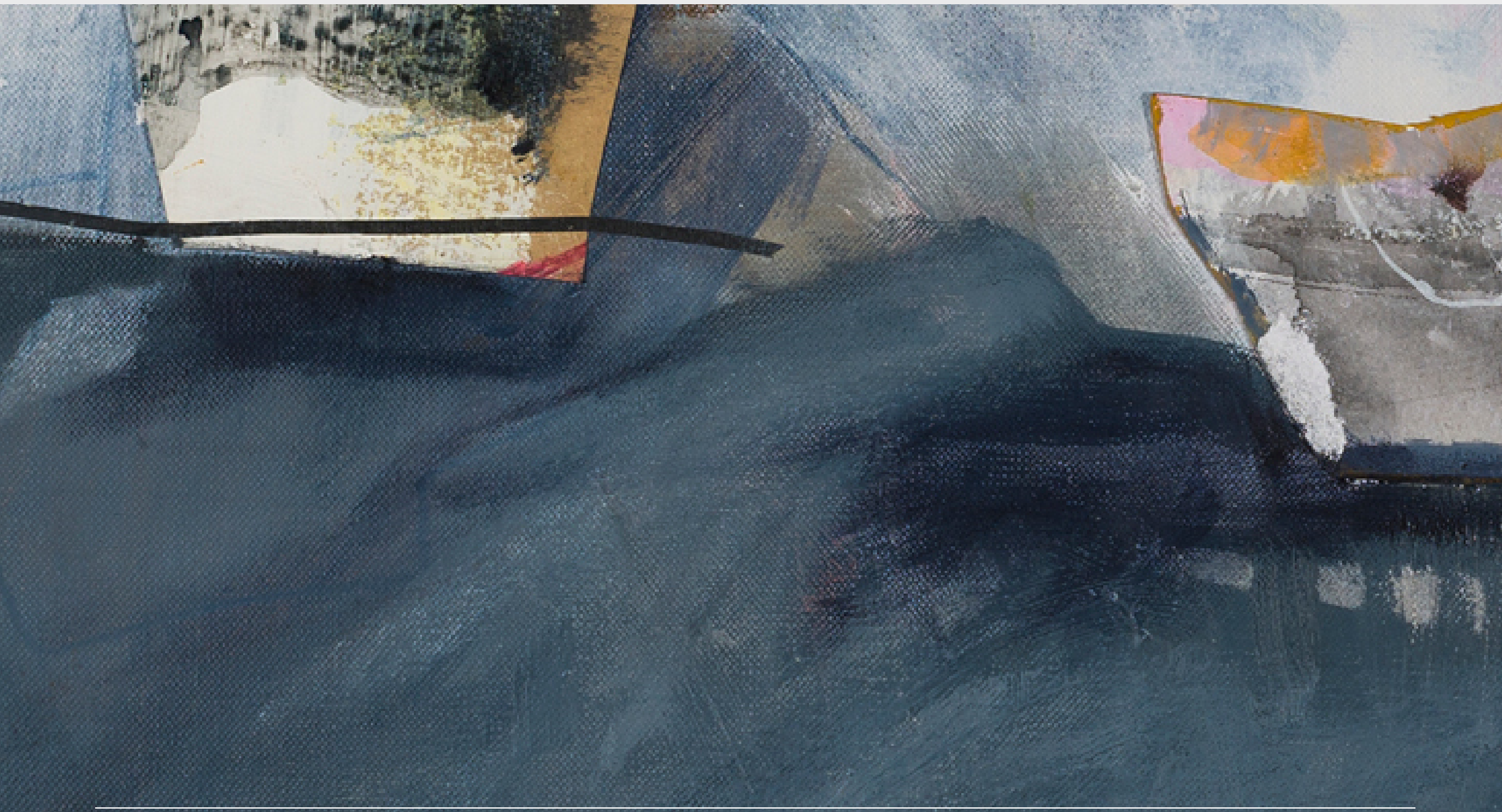
Consolidation has been another prominent theme. Mergers have reduced the number of listed entities (but not necessarily the market capitalisation), and on-market buy-backs have become popular with entities trading at below net asset value who want to return cash to shareholders while they wait for growth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

ABOUT KING & WOOD MALLESONS

A firm born in Asia, underpinned by world class capability. With over 3000 lawyers in 29 global locations, we draw from our Western and Eastern perspectives to deliver incisive counsel.

We help our clients manage their risk and enable their growth. Our full-service offering combines un-matched top tier local capability complemented with an international platform. We work with our clients to cut through the cultural, regulatory and technical barriers and get deals done in new markets.

JOIN THE CONVERSATION

SUBSCRIBE TO OUR WECHAT COMMUNITY.
SEARCH: KWM_CHINA

Asia Pacific | North America
King & Wood Mallesons refers to the network of firms which are members of the King & Wood Mallesons network. See kwm.com for more information.

www.kwm.com