KING&WOOD MALLESONS
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M&A IN THE CITY

2023

Port by Jane Hoggard

WELCOME TO KWM'S M&A IN THE CITY

It's really anyone's guess on where M&A activity will land this year.

Coming into 2023, macro economic headwinds – inflation, rising interest rates, and unrest overseas – are still lingering from the previous year. Will we see a renewed surge of M&A activity, will the market remain as is, or will we return to pre-2021 deal activity (or worse)?

What we do know is that challenges and change will create opportunities for deal-makers, particularly private capital and multinationals who have dry powder and are experienced and motivated to do deals in difficult conditions. Geopolitics may balloon around, but China's leadership has made it clear that the next 5 years will be pro-business. Additionally, some deals will be driven by the continued acceleration of shareholder and stakeholder activism and a focus on ESG, especially as we witness significant shifts in energy infrastructure transition and energy sector policy.

In our first edition of M&A in the City for 2023 we share our insights on what to look out for in key areas including Private Capital, Health, and Energy. We also share a series of in-depth pieces on how we've seen the technical and tactical elements of our M&A market play out in recent times – noting that there have been some significant recent developments!

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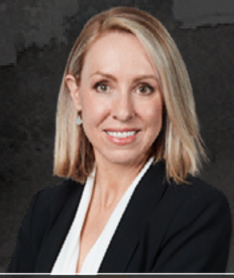

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WHAT TO WATCH FOR IN…

PRIVATE CAPITAL

Nicola Yeomans | Sarah Yu

In 2023, the Federal Government's plan to review the performance test will have dire consequences for funds that fail and will loom large for super funds. The outcome of that process will unquestionably drive investment behaviour in what is a period of market shift. With a gloomy outlook, 2022 saw funds move towards defensive assets. The question for 2023 is – when will that shift back? And how are fund managers positioned to capitalise?

As the pendulum swings back to growth, we expect the take-private trend will continue apace. Even if interest rates remain high, super funds' long-time horizons will give them a competitive edge in asset markets.

On the domestic front, Government willingness to underwrite returns for social housing projects will encourage projects in that sector. The direction this provides is reflective of the broader trend and widening scope of for-purpose investment. Perhaps not surprisingly, under the broader ESG theme, super funds will also continue placing a premium on 'green assets.'

Consistent with the imperative to make sufficient mandate-fulfilling investments, a serious strategic question will also arise for larger funds – as they grow, at what point do they open overseas offices? With the Euro slowdown and questions over the US, we will be watching for moves into Asia, following the footsteps of the Canadian pension funds. Where exactly in Asia will be interesting to see.

ESG M&A

Meredith Paynter | Emma Newnham | Cal Maher

ESG issues remain red hot so it is increasingly important to investigate and, where possible, address these issues as part of any transaction.

Bidders and their advisers should actively scope their due diligence investigations to cover ESG issues (such as compliance with climate commitments and related disclosures, underpayments, cultural heritage, and cyber-risks), and consider whether any identified issues can be managed, or give rise to unacceptable operational, financial and/or reputational risks.

As bidders grapple with how to conduct effective due diligence investigations that appropriately address ESG considerations (for which there is unfortunately no 'one size fits all') we think it will come down to three things:

1. Pivoting away from the traditional focus on identifying 'red flags' or 'deal breakers'
2. Asking questions informed by the bidder's sustainability strategy and ESG frameworks and the target's industry
3. Probing for a broader understanding of the target's ESG risk governance approach.

This could include reviewing historical disclosures and practices that may emerge as serious risk issues. In addition, if entities promote sustainability or green practices as part of their value proposition to their investors or other stakeholders, they should ensure they have a reasonable basis for making those statements and adopt and implement policies and procedures as part of their investment process that appropriately reflect their stated ESG commitments.

And of course, management of ESG issues does not end at completion. Given the inherent limitations of relying on warranties and indemnities to solve risk issues, we expect to see enhanced efforts to address ESG issues identified in the due diligence process as part of transition and integration processes. This will be key to determining whether the transaction is a success from an ESG, and overall, perspective.

ENERGY TRANSITION / NEW METALS / NEW ENERGY

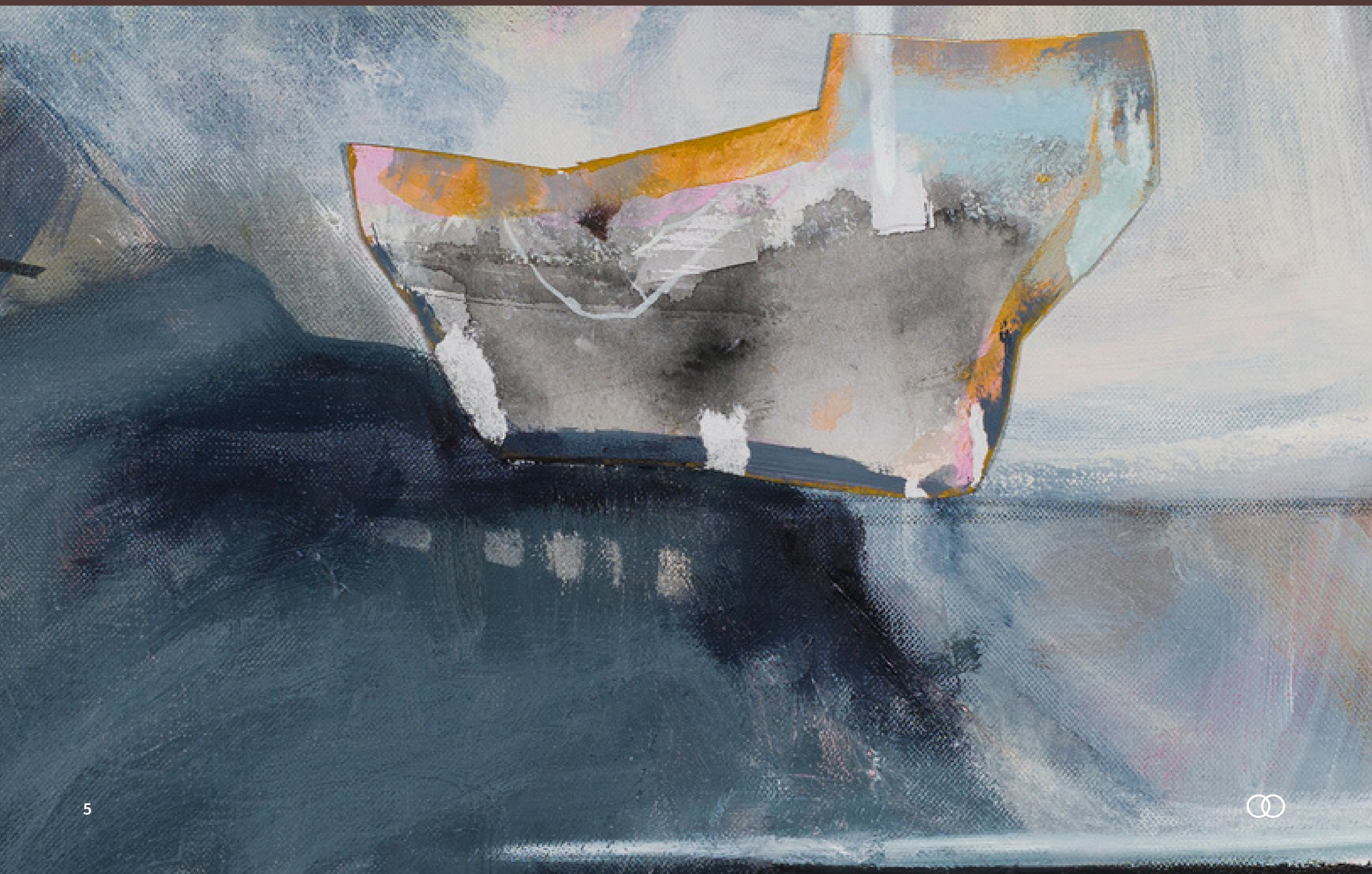
Jo Crew | Roger Davies

It seems like the most talked about game in town in recent times, but behind all of the rhetoric, is anything actually happening as part of the 'energy transition?' Very definitely 'yes' is the answer!

The decarbonisation imperative is channelling enormous creativity and investment into innovative solutions to address the challenges associated with accelerating the shift to net zero. Technological advances in electricity storage and use, as well as emerging offshore wind development and increasingly efficient solar power, coupled with friendlier, more certain regulatory regimes, will continue to make investment in renewables and associated network infrastructure attractive. While the availability of funding in a higher cost environment may be an ongoing challenge in 2023, the attractiveness of these projects to institutions with mandates for quality ESG-focussed investment products may result in more willing capital markets.

Increasingly recognised as a scalable solution, interest in hydrogen is expanding rapidly beyond the trailblazers and early-stage collaborators. Transitional energy players, industrial users, infrastructure and super funds are all exploring the challenge that is producing verifiably-green hydrogen at scale. Developing the physical, regulatory and investment infrastructure for this nascent fuel promises significant opportunities for project proponents, sponsors, investors, customers and governments alike.

The accelerating demand for transition economy commodities, geopolitical considerations discussed above and COVID-era supply-chain challenges converge in energy, energy infrastructure, new metals and critical minerals sectors. These markets offer a range of opportunities and acquisition potential with the successful navigation of regulatory and strategic challenges – M&A in this sector will continue to build.



DATA & TECH

Anthony Boogert | Kate Creighton-Selvay

Expect conservative valuations and detailed due diligence to be the themes of tech M&A in 2023. Why? There are a few factors that played out in 2022, off the back of an already expected decrease in tech deals that same year – the (speedy) rise of funding costs, the return of inflation and geopolitical factors.

So what does that mean? Tech deals became much harder to execute last year and we expect that to continue in 2023. Nevertheless, we expect tech deals to continue to represent a meaningful proportion of M&A activity, with strong interest in digital infrastructure transactions to continue, together with opportunities for consolidation in nascent tech players – and potentially some distressed transactions for companies struggling with funding costs.

With a number of high-profile cyberattacks in late 2022, we also see cyber risk moving from theoretical risks to a high priority diligence area. The prospect of acquiring a company only to find out it was subject to an unknown cyberattack during previous ownership is now very real, as is regulatory focus on C-suite and Board accountability for cyber risks. Anti-trust / competition regulatory considerations are also likely to remain at the forefront for big players.

Going forward, we expect acquisition targets to be judged by their pathway to profitability and compliance culture, with patience for distant profits and a laissez-faire approach to legal and compliance risks a thing of the past. We see this as a 'reversion to the mean' though, with revenue growth at all costs being replaced by a focus on financial discipline and risk management capability. This will be a time for less flashy but robust tech companies to shine, such as those in B2B software. While fewer, speculative plays will remain part of the tech landscape, for early-stage funding rounds and will include 'wow factor' innovation such as generative AI.

HEALTH

Alex Elser | Jason Watts

We see clear M&A opportunities in the healthcare sector in 2023, particularly from innovation which responds to the key thematics shaping the industry.

Ever-increasing leverage of technology and data will be absolutely critical to improving patient experiences, outcomes and financial performance. An exciting area to watch is the ongoing development and use of AI in diagnostics (including home diagnosis) and treatment. Naturally, with increasing technological leverage, data sharing and data collection, management of cyber risk is an absolute must, as well as a key due diligence issue.

Facing into the information management challenge will also be critical to making the right decisions about patient care, growing patient trust and encouraging participation in a technology-based health sector, all of which will underpin its viability.

Efficiency will be the other key driver of activity in 2023. Expect moves to contain or reduce costs and improve system resilience, including to manage labour shortages and workforce uncertainty. Changing care models, driven by demographic and cost imperatives, enabled by technological advances and reflected in Government policy will also continue to revolutionise the healthcare sector. Developing and delivering care at home models, specialised facilities and leveraging consumer technology like wearables are several ways this is playing out, each presenting opportunities.

The rise of healthcare as an infrastructure-like asset class is now well established as a major investment thesis, which will continue given Australia's healthcare sector structure and financing model. Listed healthcare entities have outperformed other sectors and, in 2023, there is already significant interest in health assets which offer growth potential or stable financial performance in the face of general economic uncertainty.

GOVERNMENT POLICY & FOREIGN INVESTMENT

Mal Brennan | Intan Eow

2022's change of government brought a welcome change of tone towards foreign investment, with ongoing stabilisation in the 'Australia – China' relations and a number of successful cross-border investments in Australia. However, the continued geopolitical uncertainty in both Asia and Europe will demand the Government maintain and develop a more nuanced approach to national security, especially in the context of cyber risk. Recent significant cyber incidents underscore the ongoing sensitivity around data and data-related issues. These will impact the way key regulators such as the Foreign Investment Review Board and Cyber and Infrastructure Security Centre deal with investors and investment applications.

Prospective parties ought to be prepared for continued heightened scrutiny around data protection, access, storage, and sovereignty considerations, and for these to be material in government decision-making. While FIRB processing times for non-sensitive proposals are improving, sensitive proposals involving security issues can still expect 6 months or so of deep scrutiny ahead of a decision and ongoing condition compliance if approved (as well as the doubled FIRB fees).

Remember, proponents will need to factor this and prospective future regulation into investment decision making. Of keen interest to many will be the United States' discussion of an outbound investment review regime with respect to sensitive sectors, potentially including semiconductors, quantum computing and AI. The European Commission has also started to look into this. While their prospects for implementation are unclear, the investment community will nevertheless be watching closely.

CROSS BORDER M&A

Antonella Pacitti | Peter Stirling

Developments in Australia and China's bilateral relationship, coupled with the continued strength of the US dollar and hopes of steadying US Fed intervention, encourage us to be optimistic regarding international buyers' interest in the Australian market for 2023, despite the uncertain economic outlook, higher inflation and interest rates.

Attention is most likely to be focussed on the energy and resources opportunities, due to two ESG-related demand and funding supply factors. As discussed elsewhere, the decarbonisation imperative is driving demand for both transition resilient energy supplies and low-carbon requisite resources such as battery and critical minerals. Even gold seems to be reclaiming its lustre, so we also expect to see those players – and others in more traditional commodities – crossing borders to enhance their resource base and to meet the diversification and sustainability expectations of investors and other stakeholders. Limited bond funding availability for mining means developers and proponents of these projects are likely to be receptive to the right investment pitch.

An interesting challenge for buyers and sellers will be mitigating the impact of 'deal muscle' depletion through pandemic-enforced inability to conduct valuable diligence and negotiate face-to-face. In the current geopolitical climate, both sides' ability to build credibility and confidence that a bid can effectively manage regulatory and completion risk could easily amount to the difference between success and failure. But credibility and confidence start with value, so if you're not able to map out the prize and identify the gaps, it makes it that more difficult to convince others.

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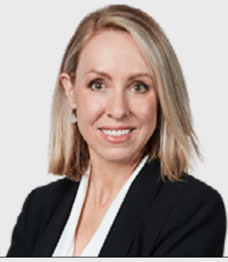

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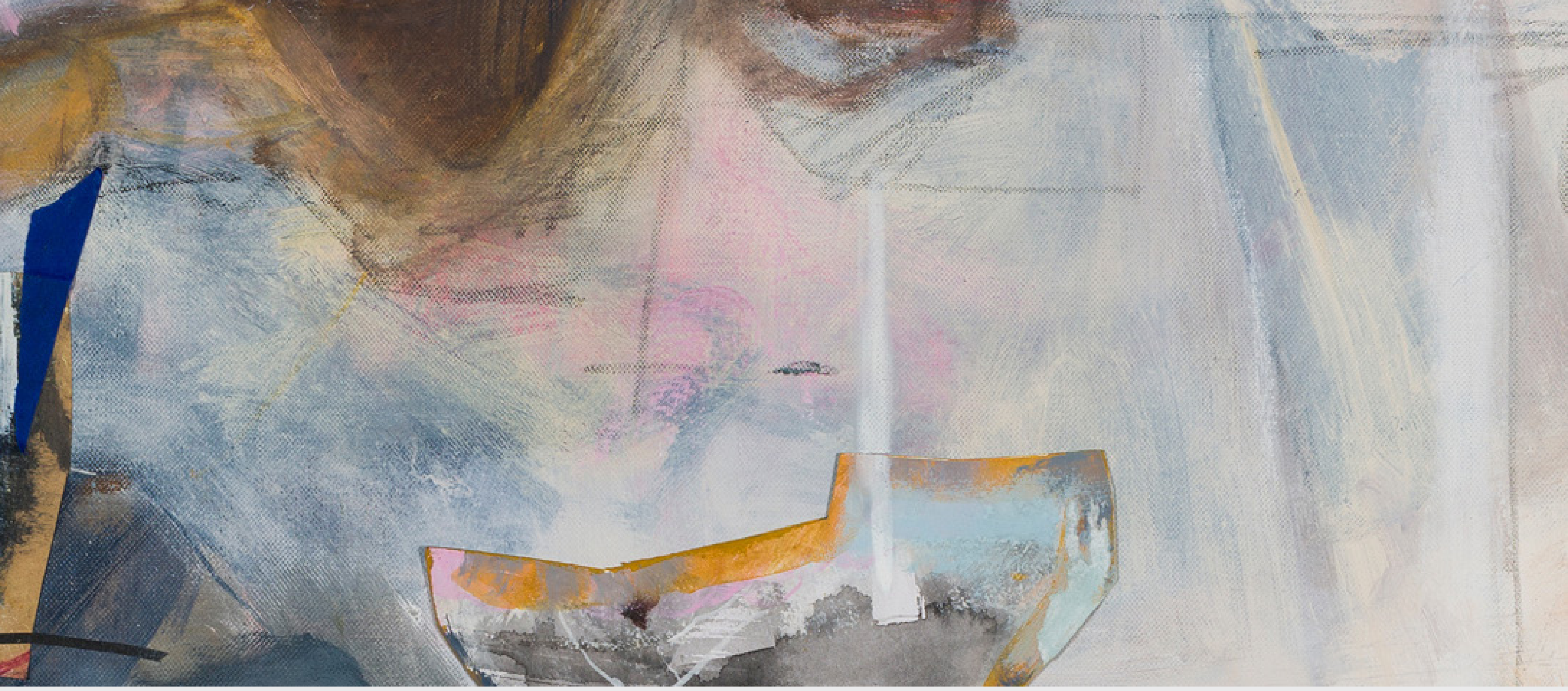

TECHNICAL & TACTICAL M&A ELEMENTS: IN-DEPTH SERIES

See our series of in-depth pieces on how we've seen the technical and tactical elements of our M&A market play out in recent times.

Takeovers Panel lays down the law (again) on pre-deal exclusivity

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