



# Special Feature

## *The boom of Australian M&A*

The world of M&A operates in fits and starts, jumping ahead at blockbuster deals, riding the crests of new waves of business from emerging markets, and then at times sputtering along until the next cycle. However, recently M&A has seen a tremendous boom throughout the world especially in the emerging markets such as India, China and Mexico. With the frenetic level of interest in these emerging markets, it is easy to overlook what is happening 'Down Under'.

Australia has been entertaining an aggressive market driven by strong M&A activity. As reported by Thomson Financial, announced M&A activity had increased 56.4 percent compared to 2005, totalling US\$163.9 billion.

The continued activity is a reflection of the strong Australian corporate sector, in conjunction with a robust private equity market as well as twelve years of continuous economic growth. Canberra-based consultancy Access Economics, one of Australia's leading economic forecasters, recently predicted a new "golden age of growth" for the economy, with the problems of worker shortages and production bottlenecks being solved amid a continuing boom in demand for commodities. Access Economics predicted that Australia's gross domestic product will soar 4.6 per cent in 2007, compared with just 2.9 percent this year, representing the strongest annual growth rate since 1997-1998.

Growth in the region has also been stimulated by the vigorous return of the Japanese economy and markets, which have a particularly strong influence in Australia. Recent activity has been at unprecedented levels.

### A week in the Australian Newspapers ...

"Suncorp offers A\$7.9bn for Promina"  
(13 October 2006)

"CVC outbids KKR as Packer's A\$4.5bn Media Partner"  
(19 October 2006)

"Macquarie lands A\$20bn Thames Water deal"  
(18 October 2006)

"KKR scraps its bid to acquire Coles Myer"  
(20 October 2006)

What exactly does this mean and why has it occurred? An analysis of the booming market yields three main themes to consider: private equity, share markets and the emergence of infrastructure funds.

### Private equity

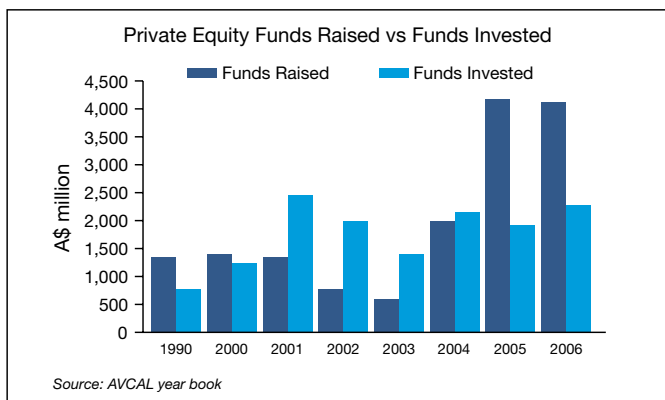
Private equity firms are taking an increasingly active role in the Australian market, participating in a growing proportion of deals and transactions.

Private equity has long been part of the Australian M&A landscape. Funds such as Pacific Equity Partners, CHAMP and CVC have been active participants in a range of deal sizes, industries and transaction structures. In addition to aggressive fund raising by the incumbent funds, the last 12 months have seen the arrival in force of the large global funds such as KKR and TPG (through local offshoot Newbridge), all of which point to a possible role for Australia as a hub for the region.

Private equity buyers have not had it all their own way. Competition for deals has increased with both trade and private equity buyers competing for deals where there has been a heightened appetite for IPOs with vendors frequently opting to pursue a "twin track" process to maximise value. In the past year, Australian transactions conducted with PE houses have included:

- Airline Partners Australia's (Macquarie / TPG backed) A\$11.1 billion (US\$8.7 billion) bid for Qantas
- CVC Asia Pacific's A\$4.5 billion (US\$3.5 billion) acquisition of 50 percent of the media assets of PBL
- KKR / Seven Networks Ltd.'s A\$4 billion (US\$3.1 billion) media joint venture
- KKR's A\$1.8 billion (US\$1.4 billion) buyout of the waste management business of Brambles
- Pacific Equity Partners' A\$1.6 billion (US\$1.3 billion) buyout of Flight Centre
- The acquisition of 106-year-old department store chain, Myer, by TPG-Newbridge for A\$1.4 billion (US\$1 billion)

Yet, with private equity involvement in some offshore markets constituting circa 15-20 percent of the total value of M&A activity, the private equity market in Australia still appears to have significant room for growth. The graph below shows the large difference between funds raised in Australia in the last two years and funds invested: the appetite for deals is currently insatiable.



Some commentators suggest that the future for private equity in Australia looks positive. Whilst the Australian equities and debt markets continue to generate strong growth, volatility within Asian markets has had an impact on the appetite of large investors such as hedge funds, which have become increasingly important for Asian market IPOs. Continued volatility within Asian markets may result in uncertainty within the Asia-Pacific region, therefore making life more difficult for Australian firms seeking foreign investment capital, and thus driving further growth in private equity.

### Share markets

The Australian share market has also recently been buoyed by major mergers and acquisitions, such as the merger between gaming companies Tattersall's and UNITAB, major transport group Toll Holdings' takeover offer for Patrick Corporation, the merger between the Australian Stock Exchange and the Sydney Futures Exchange, and the recently announced US\$6 billion merger of Suncorp and Promina in the insurance/banking sector. Increasingly, a rising number of conglomerates have sought to unlock value for shareholders by de-merging non-core operations into separate vehicles. Examples include the ALH Group, which Foster's sold to Woolworths in 2004.

Much of the recent strength of the Australian share market can be attributed to the strong performance of the finance and resource sectors. Together, listed companies from these two sectors make up nearly 50 percent of the value of the Australian share market. The finance sector has benefited significantly from the consistent growth of the Australian economy, as well as the very strong Australian property market. Now, with the successful circa US\$7 billion takeover of WMC Resources by BHP Billiton completing the most recent cycle of mega-mergers, attention is being focused on the growing crop of midcapitalisation independent miners, which have experienced stellar price gains on the back of the booming commodity markets. The Australian resources sector has risen sharply as the prices for commodities such as gold, oil, and base metals have surged. The performance

of the Australian economy and the Australian share market have always been closely tied to commodity prices, and with the expected continuation of commodities demand from China, the Australian market is expecting further interest in the energy and utilities sectors.

The Australian share market currently makes up only about 2 percent of the value of the world's total share markets. In particular, the Australian market is under-represented in sectors such as technology, consumer brands, and pharmaceuticals. This has led some analysts to predict significant growth opportunities within Australian markets; a theory which is currently being tested by the Australian Government in its A\$15.5 billion (US\$12.2 billion) T3 share sale, its disposal of the last remaining Government-held stake in Telstra, the national phone carrier.

### Infrastructure funds

Global infrastructure funds led by Australian financial players such as Challenger, Babcock & Brown, and Macquarie Bank have introduced a pioneering new type of globalism in the utilities sector and are redefining the shape of industry ownership and risk. They are predominantly taking the regulatory risk through investments in regulated and network assets, while traditional utility players take the energy trading risk present in other parts of the energy chain. Australian institutions led the way in 2005, with the emergence of infrastructure funds buying up water, electricity and gas assets across the world. In 2006, Macquarie has continued to dominate, leading a consortium for the US\$15 billion takeover of Thames Water announced in October 2006.

The volume and value of deals done by infrastructure funds in the electricity and gas asset class has exploded, fuelled by the potential of foreseeable income and longterm capital gains. In 2005, six out of seven Australian deals – ranked in the top 100 global transactions – were carried out by infrastructure funds, with a total value of US\$4.3 billion. In the previous year, one out of six Australian deals in the top 100 was conducted by an infrastructure fund and that particular deal was valued at US\$1.2 billion. 2006 appears set to continue the trend.

### Strong prospects

With such a high supply of capital, continued strength in the fundamentals underpinning the Australian economy and huge appetite for growth, Australia is likely to see strong levels of M&A activity for years to come. The interesting question is to what extent Australia can be an Asia-Pacific hub for M&A activity, drawing on local talent, deal experience and a plentiful supply of capital.