New Zealand M&A – trends and insights

MARCH 2015

This publication provides a snapshot of New Zealand's M&A market, exploring the key themes that we expect to characterise deal activity in 2015.

Chapman Tripp's team of M&A experts plays a major role in many of New Zealand's largest and most complex transactions. We were ranked New Zealand's top legal firm by deal volume in Mergermarket's and Thomson Reuters' 2014 legal advisor M&A league tables for Australasia.

Sustained confidence – New Zealand economic overview

2015 has been dubbed the year of the "Goldilocks" economy for New Zealand – not too hot, not too cold. Reserve Bank of New Zealand (*RBNZ*) forecasts are for annual GDP growth of 3% and falling unemployment supported by continued low inflation (if not a period of temporary deflation triggered by collapsing oil prices).

Domestic demand has maintained its momentum and, importantly, appears to be sustainable in light of continued increases in the economy's productive capacity. This lift has been attributed to two factors – labour force growth (both in size and participation rates) and increased business investment. The investment share of real GDP has risen from 21% in 2011 to 24% in 2014.

Business and consumer confidence remains high relative to historical norms. The latest NZIER Quarterly Survey of Business Opinion recorded a 21% net optimism level, while the ANZ-Roy Morgan Consumer Confidence Index was at 128.9 in January 2015, well above the decade average of 119 and up from around 110 in 2012.

Most of the risks are international.

Deflation and ongoing economic malaise in Europe may lead to a slowdown in demand for export products. Volatility in commodity prices also presents some uncertainties. International dairy prices fell 52% last year, although there are now early signs of a recovery. New Zealand is also vulnerable to a slowing in the Chinese economy, China now contending with Australia as our largest trading partner. On the other side of the ledger, the RBNZ estimates that the sharp drop in oil prices (down around 58% since the end of June 2014) will boost GDP by around 1%.

M&A trends

Big and small

The growing economy combined with low interest rates and an increasing willingness on the part of banks to lend, is translating into an increased corporate appetite for M&A transactions. Reports show a healthy and steady boost in deal volumes over the past 12 months, with interest from both listed corporates and private firms looking to expand operations and diversify earnings.

2014 was characterised by small to mid-sized transactions, in both the trade and financial sponsor spheres, punctuated by a small but growing number of major deals such as Beijing Capital Group's $950m purchase of Waste Management from Transpacific Industries, and Oji/INCJ's $1.037b acquisition of Rank Group's Carter Holt Harvey Pulp & Paper business.

This trend looks set to continue in 2015, with domestic corporates pursuing strategic acquisitions (often involving vendors dealing with generational transition) and New Zealand private equity firms focusing on investments in the up to $100m segment. Blockbuster deals approaching or exceeding the $1b threshold will likely continue to be the preserve of offshore purchasers.

China and the wider Asian story

The China-New Zealand relationship continues to deepen, almost seven years since the Free Trade Agreement was signed in Beijing. The benefits to New Zealand's export-dependent economy of greater access to the Chinese market are substantial.

Although China's economic growth has slowed from the very high rates of 2004 to 2011, Chinese investors continue to show keen interest in New Zealand investment opportunities across an increasingly wide range of sectors. For example, Beijing General Aviation Group recently acquired a 50% stake in New Zealand aviation firm Pacific Aerospace.

In the agricultural sector, Chinese investors are increasingly focusing on vertical integration of supply and marketing, rather than simple land ownership.

New Zealand's Asian story is broad. Last year, Japanese paper manufacturer Oji Holdings and Japanese government-backed investment fund Innovation Network Corporation of Japan purchased the pulp, paper and packaging business of Carter Holt Harvey for $1.037b. Juice Products New Zealand sold 80% of its shares to Japan's Sumitomo Corporation and biscuit-maker Griffins was sold to Philippines-based food giant Universal Robina Corporation for $700m.

Overseas investment

New Zealand is an attractive destination for foreign direct investment, despite having the seventh most restrictive screening regime in the OECD.

Obtaining consent for a business purchase not involving "sensitive land" is relatively straightforward although potential investors must satisfy an investor test that assesses their character, relevant business experience, acumen and financial commitment to the investment.

Acquisition of sensitive land and fishing quota requires the consent of two Ministers and, in addition to the investor test, a "benefits test" which examines whether the investment will result in benefits to New Zealand.

Increasingly, the OIO requires a detailed business plan to substantiate these benefits, including hard data on planned capital investment, job creation, increased productivity and export receipts. Enforceable commitments to proceed with promised plans will typically be a condition of consent.

Satisfaction of the benefits test may require identification of a hypothetical New Zealand purchaser (even if no actual New Zealand bidder exists) and consideration of what benefits might reasonably arise from ownership of the assets by this hypothetical New Zealand purchaser.

This "counterfactual" analysis represents an evolution in analytical approach that adds additional complexity to the consent process and poses particular challenges when acquiring mature assets where there is limited scope to lift productivity, deploy new technology or create new jobs.

In our experience these challenges can generally be met, but can require a considerable commitment of time and effort on the part of intending investors and their management teams.

The application process can be frustratingly time-consuming, reflecting a high number of applications and limited resources in the Overseas Investment Office (*OIO*). At no stage in the 13 months to the end of January 2015 did the OIO have fewer than 60 consent applications in progress, and at its peak – in October – it had 73. These volumes are challenging the regime's capacity.

Although there are no statutory time frames for decision-making, the OIO's target is to have 90% of business and land acquisition proposals assessed within 50 working days of active consideration. It achieved a hit rate of only 76% in the second half of 2014. In our experience, processing of complex applications can take closer to 100 working days, when time for correspondence with the OIO and Ministerial sign-off is factored in.

The 2014 Briefing to the Incoming Minister (*BIM*) noted that timing of decisions could have personal implications for various applicants, including funding arrangements.

Reform of the screening regime is always contentious, particularly if the direction of the reform is toward liberalisation, but most of the emotion in the debate is around land and other natural resources. It is our view that the New Zealand public would take a much more pragmatic attitude to the treatment of business assets and listed companies, and that reform in this area is overdue and could yield real dividends.

An example would be to treat NZX listed companies with no more than 49% foreign ownership or control as New Zealand companies for the purpose of the Overseas Investment Act. This has been on the government's capital markets Business Growth Agenda for years now so it is disappointing that it is still on the 'to do' list.

The burgeoning Māori economy

Sophisticated post-settlement Māori corporations are increasingly active in the general M&A market. For example, in August 2014, Ngai Tahu Holdings Corp and Tainui Group Holdings, two tribal (iwi) investment entities, acquired national passenger transit firm Go Bus for $170m.

The government-owned New Zealand Superannuation Fund announced in March 2014 that it had sold a 2.5% stake in New Zealand's largest forestry business, Kaingaroa Timberlands, to six central North Island iwi. The investment is one of the biggest ever involving an iwi collective. In 2013, NZ Super had valued its Kaingaroa investment, which includes 190,000 hectares in the central North Island, at $945m.

We expect that in the near term iwi investment vehicles will continue to focus on primary industries (such as fishing and agriculture) and infrastructure. As their wealth continues to accumulate, they will play an increasingly important role in the domestic M&A market.

Listing boom and the dual track

$4.74b of new capital was raised and 16 new listings were added to the NZX in 2014, making it the busiest year for floats since 2004. With the exception of the Government's listing of Genesis Energy, the offerings were a mix of small to mid-sized businesses seeking growth capital, entrepreneurial roll-up transactions and private equity exits.

We expect the IPO pipeline to keep pumping on the back of continued low interest rates and bond yields and a supportive and enabling regulatory environment. The continued strength of the equity capital markets means that the option of an IPO exit is increasingly being considered alongside the more traditional M&A route. See our report: *New Zealand Equity Capital Markets – trends and insights*, for more analysis.

Australian private equity

Historically, the New Zealand private equity market has been characterised by domestic players in the mid-market, with blockbuster deals typically the preserve of offshore, mostly Australian, firms. In the more constrained environment following the global financial crisis, the Australian presence has been subdued but this seems to be starting to change.

Although acquisitions of the size of Independent Liquor and Yellow Pages (each more than $1b) appear unlikely, Australian private equity (and the Australian outposts of major American and European firms) do appear to be at least "kicking the tyres" on New Zealand investment opportunities. The coming year may see this interest translate into significant transactions.

Takeovers and the return of the scheme of arrangement

Public market takeover activity has been limited in recent years but it seems logical to assume that the same conditions which are driving an increase in general M&A activity will provide a stimulus to the public markets as well.

One development which might encourage public market M&A is the reform of the laws governing public company schemes of arrangement and the public acceptance by the New Zealand Takeovers Panel that schemes are a legitimate transaction structure, even in situations where the transaction concerned could be effected through a takeover offer regulated under the Takeovers Code. This represents a step-change from the Panel's earlier view that such transactions were "takeovers in drag".

Subject to shareholders being provided with disclosure and explanatory material of an equivalent standard to offers under the Takeovers Code, and shareholder interest classes being properly identified, the Panel has indicated that it will not object to an application seeking court approval for a scheme of arrangement involving the effective takeover of a company subject to the Takeovers Code, including where existing shareholders are squeezed out for cash.

One challenging feature of a scheme involving a public company is the shareholder votes needed for approval. Separate resolutions of each interest group are required, with 75% of the votes of those shareholders entitled to vote and voting needed for passage. Potentially more challenging in some contexts is the additional need for a resolution supported by a simple majority of all votes entitled to vote, regardless of the number of votes actually cast. This second resolution may, depending on the makeup of the relevant share register, require greater proxy solicitation than has been New Zealand practice.

It is unlikely that schemes will immediately assume the prominence they enjoy in Australia. Although now blessed by the Panel, they continue to be regarded with suspicion by some prominent market commentators, and the historical hostility of the Panel may influence the thinking of public company directors. Over time, however, the attractive features of a scheme versus a takeover offer, such as their inherent all-or-nothing certainty and the lower thresholds for approval, could make them a more common feature of the New Zealand markets.

Equity derivative disclosure

Equity swaps are sometimes used by investors to gain exposure to the economic performance of a particular security, without the need to acquire the underlying physical security. Investment banks offering such products will however often acquire the underlying security as a hedge against their counterparty exposure under the swap.

Concerns have been expressed, not without foundation based on examples in Australia and the USA, that the eventual natural buyer of the physical securities acquired as a hedge may be the counterparty to the equity swap. In this way, equity swaps could be used to effectively warehouse shares in a target company, in advance of a takeover offer or other corporate transaction.

Responding to this concern, New Zealand's new Financial Markets Conduct Act and the Takeovers Code now require public disclosure of certain equity derivative positions.

The ability to use equity swaps to take substantial equity positions without requiring disclosure has been curtailed, although synthetic investment may still have some taxation benefits. Investors contemplating such transactions should seek advice and make sure their disclosure procedures are updated to reflect the new requirements.

Chapman Tripp recent M&A highlights

We have recently advised:

- a Japanese consortium (Oji Holdings Corp and Innovation Network Corporation of Japan) on its $1.037b acquisition of Carter Holt Harvey's pulp and paper and packaging businesses
- Beijing General Aviation Group on its 50% equity investment in New Zealand aviation firm Pacific Aerospace
- Wilmar International and First Pacific on the NZ aspects of their AU$1.34b takeover of Goodman Fielder, Australasia's largest food manufacturer
- Australian waste management company Transpacific Industries on the $950m sale of its New Zealand business to a wholly owned subsidiary of the Beijing Capital Group
- GIC Real Estate, Singapore's sovereign wealth fund, on its NZ$1b joint venture with Scentre Group – Westfield mall owner and operator – to take a 49% stake in five New Zealand shopping centres
- ID Leisure Ventures, founded by Chinese billionaire Sun Xishuang, on the New Zealand elements of their AU$900m acquisition of Hoyts Group
- BlueScope Steel, Australia's largest steelmaker, on its $120m acquisition of Fletcher Building Limited's Pacific Steel Group assets
- Guardians of New Zealand Superannuation Fund on the sale of NZSF Timber Investments (No 3) Limited's forestry assets to China National Forest Products Trading Corporation, a subsidiary of state-owned China Forestry Group Corporation, for an undisclosed sum, with the remaining going to local investors
- The London Stock Exchange Group plc on the New Zealand elements of their US$2.4b acquisition of Frank Russell Company, and
- Discovery Communications and Liberty Global on the New Zealand aspects of their $1.07b acquisition of British-based All3Media, the parent company of South Pacific Pictures, New Zealand's largest screen production company.

For more information, please contact

AUCKLAND

JOHN STROWGER – PARTNER
T: +64 9 357 9081
M: +64 27 478 1854
E: john.strowger@chapmantripp.com

BARRY BROWN – PARTNER
T: +64 9 357 9255
M: +64 27 446 3388
E: barry.brown@chapmantripp.com

RACHEL DUNNE – PARTNER
T: +64 9 357 9626
M: +64 27 553 4924
E: rachel.dunne@chapmantripp.com

PIP ENGLAND – PARTNER
T: +64 9 357 9069
M: +64 27 434 8854
E: pip.england@chapmantripp.com

STEPHEN LOWE – PARTNER
T: +64 9 357 9042
M: +64 27 490 4633
E: stephen.lowe@chapmantripp.com

TIM TUBMAN – PARTNER
T: +64 9 357 9076
M: +64 27 344 2178
E: tim.tubman@chapmantripp.com

ROGER WALLIS – PARTNER
T: +64 9 357 9077
M: +64 27 478 3192
E: roger.wallis@chapmantripp.com

NICK WELLS – PARTNER
T: +64 9 357 9004
M: +64 27 449 0041
E: nick.wells@chapmantripp.com

WELLINGTON

JOSH BLACKMORE – PARTNER
T: +64 4 498 4904
M: +64 21 828 814
E: josh.blackmore@chapmantripp.com

GEOF SHIRTCLIFFE – PARTNER
T: +64 4 498 6322
M: +64 27 481 1699
E: geof.shirtcliffe@chapmantripp.com

CHRISTCHURCH

ALISTER MCDONALD – PARTNER
T: +64 3 353 0392
M: +64 21 477 935
E: alister.mcdonald@chapmantripp.com

JOHN HOLLAND – PARTNER
T: +64 3 353 0027
M: +64 27 437 7583
E: john.holland@chapmantripp.com

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Large Law Firm of the Year - 2014 New Zealand Law Awards

Employer of Choice (100+ employees) - 2014 New Zealand Law Awards

New Zealand Employer of Choice - 2014 Australasian Lawyer Employer of Choice Awards

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AUCKLAND
23 Albert Street
PO Box 2206, Auckland 1140
New Zealand
T: +64 9 357 9000
F: +64 9 357 9099

WELLINGTON
10 Customhouse Quay
PO Box 993, Wellington 6140
New Zealand
T: +64 4 499 5999
F: +64 4 472 7111

CHRISTCHURCH
245 Blenheim Road
PO Box 2510, Christchurch 8140
New Zealand
T: +64 3 353 4130
F: +64 3 365 4587

www.chapmantripp.com

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